ADMINISTRATION'S REQUEST FOR AN INCREASE IN THE PUBLIC DEBT LIMIT AND ON ADDITIONAL FINANCING NEEDS OF THE RESOLUTION TRUST CORPORATION

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

JULY 11, 1990

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ADMINISTRATION'S REQUEST FOR AN INCREASE IN THE PUBLIC DEBT LIMIT AND ON ADDITIONAL FINANCING NEEDS OF THE RESOLUTION TRUST CORPORATION

WEDNESDAY, JULY 11, 1990

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 9:30 a.m. in room 1100, Longworth House Office Building, Hon. Dan Rostenkowski (chairman of the committee) presiding.

Chairman ROSTENKOWSKI. This morning we will hear from the administration on the requested increase in the public debt limit, and on additional financing needs of the Resolution Trust Corporation.

This hearing is in response to a letter sent to me by the Secretary of the Treasury, Nicholas Brady, dated June 28, 1990.

Without objection, a copy of this letter as well as the press release announcing this hearing will be made a part of the hearing record.

[The letter referred to and the press release announcing the hearing follow:]

FOR IMMEDIATE RELEASE
THURSDAY, JUNE 28, 1990

PRESS RELEASE #32
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1721

THE HONORABLE DAN ROSTENKOWSKI (D., ILL.), CHAIRMAN, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON THE ADMINISTRATION'S REQUEST FOR AN INCREASE IN THE PUBLIC DEBT LIMIT AND ON ADDITIONAL FINANCING NEEDS OF THE RESOLUTION TRUST CORPORATION (RTC)

The Honorable Dan Rostenkowski (D., Ill.), Chairman of the Committee on Ways and Means, U.S. House Representatives, today announced that the Committee will hold a hearing on the Administration's request for an increase in the public debt limit, and on additional financing needs of the Resolution Trust Corporation (RTC). The hearing will be held on Wednesday, July 11, 1990, in the Committee's main hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.

In a letter dated June 28, 1990, from the Honorable Nicholas F. Brady, Secretary of Treasury, the Administration has indicated that the current limit on the public debt of $3,122.7 billion will be exceeded in mid-August. Secretary Brady's letter states that "it appears likely that, without an increase in the public debt limit, the Treasury will run out of cash and borrowing authority and default on the Government's obligations in mid-August. However, a significant increase in the level of RTC spending above the current estimate could accelerate the need for an increase in the debt limit to early August. In any case, it is highly likely that default would occur before Congress returns in September."

In announcing these hearings, Chairman Rostenkowski made the following statement: "It is critical that we pass an increase in the public debt limit before we adjourn for the August recess. In addition, the Administration needs to inform us of RTC's further financing needs. Specifically, we need to know (1) why additional financing above that provided in FIRREA last year is necessary; (2) how much additional financing is needed; (3) when the current amount of authorized RTC financing will be exhausted; and (4) what form the additional financing should take."

Oral testimony will be heard from <u>invited witnesses only</u>. However, any interested individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

<u>DETAILS FOR SUBMISSION OF WRITTEN COMMENTS</u>:

For those who wish to file a written statement for the printed record of the hearing, six (6) copies are required and must be submitted by the close of business on Monday, July 16, 1990, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 150 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, before the hearing begins.

<u>FORMATTING REQUIREMENTS</u>:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will **not** be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

THE SECRETARY OF THE TREASURY
WASHINGTON

June 28, 1990

COMMITTEE ON
RECEIVED
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The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing to advise you of the need for action by Congress on legislation to increase the limit on the public debt in early August before the scheduled Congressional recess.

As you know, the Resolution Trust Corporation's (RTC) borrowing from the Federal Financing Bank is funded through the normal Treasury debt management process, and, therefore, affects the debt subject to limit. As a result, our debt and cash estimates for the rest of Fiscal Year 1990 are subject to a greater-than-usual degree of uncertainty because of the RTC's difficulty in predicting the timing and level of its need for funds.

Based on our current estimate, it appears likely that, without an increase in the debt limit, the Treasury will run out of cash and borrowing authority and default on the Government's obligations in mid-August. However, a significant increase in the level of RTC spending above the current estimate could accelerate the need for an increase in the debt limit to early August. In any case, it is highly likely that default would occur before Congress returns in September.

As you are aware, the limit is ordinarily raised to a new permanent level sufficient to fund the Government's needs for the upcoming Fiscal Year. Treasury will request a permanent debt limit increase as soon as the mid-session review of the budget is available from OMB. At that time, we will also advise you of our best estimate of the date that default would occur absent action to increase the debt limit.

I urge the Congress to act in a timely manner on a debt limit increase in order to avert a default with its adverse consequences on domestic and international confidence and trust in the United States.

Sincerely,

Nicholas F. Brady

Chairman ROSTENKOWSKI. The first item the committee will consider this morning is the administration's request for an increase in the public debt limit. The present limit is $3.1 trillion. Secretary Brady has informed this committee that the Congress must act to increase the debt limit by early or mid-August, depending upon the level of borrowing in the Resolution Trust Corporation.

The administration has not specified the new debt limit required. Secretary Brady has informed me that the administration will request a permanent debt limit increase as soon as the midsession review of the budget is available from the Office of Management and Budget.

The purpose of today's hearing is to obtain from the administration their most recent estimates of when the Treasury will run out of money, and their view of the effect of the savings and loan bailout on Federal borrowing needs.

Last August, during the House debate on the conference report of the savings and loan bailout legislation, I predicted the administration would soon be forced to come back to Congress to obtain additional funding to assist in the bailout of insolvent thrift institutions.

Unfortunately, less than 1 year later, it's apparent that much more will be needed. In considering the funding needs of the bailout program and the impact of such funding on overall levels of Federal debt, this committee must be provided information from the administration on several issues. First, we need to know why additional financing is needed.

Second, we need to know the administration's estimate of how much additional financing is necessary.

Third, we will inquire as to the administration's estimate of when the current amount of authorized spending will be exhausted.

And fourth, we must consider what type of additional financing is necessary.

Our first witness today is Mr. Robert Glauber, Under Secretary of Finance, Department of the Treasury. Welcome, Mr. Glauber.

I yield first to Mr. Archer.

Mr. ARCHER. Thank you, Mr. Chairman, and thank you for holding these hearings today because the subject of increasing the Government's debt limit is always an important one.

But our consideration of an extension of that limit carries with it far greater significance now as we approach an important phase of the deficit reduction negotiations.

I appreciate Under Secretary Glauber's appearance here today, and I would hope that this hearing will not degenerate into an exercise in shooting the messenger who brings us news we don't want to hear.

Yes, I am discouraged by the message regarding the need for an increase in public debt and the multitude of reasons for that increase. I would hope, however, that we can spend our time productively deciding where we go from here rather than allowing the discussion to degrade into partisan political bickering.

While we have anticipated the arrival of the bad news for some time, reality is now at our front door. There are a number of ways we can approach the problem in the form of a variety of short-term and long-term extension options which readily lend themselves to all sorts of mischief and budgetary politics.

This year our choices are influenced to a great extent by the timing of other activities going on around us. We cannot escape the fact that we are in a highly charged political atmosphere. We can, however, refrain from allowing that fact of life in the Capitol to dominate our consideration of the basic issue before us.

Certainly it's appropriate that we will hear testimony and engage in a discussion of the reasons why the limit is being breached earlier than was anticipated when it was last increased.

One obvious focus is the increasing cost of the RTC's effort to deal with the S&L debacle, and I know that subject will be a major one to pick on today as we grapple once again with dealing with the illusive objective of quantifying the size of that effort.

To date, no one's numbers have been completely accurate, as you said, Mr. Chairman, because we are dealing with a moving target whose motions are dependent upon too many uncontrollable forces.

As the thrift, banking and financial services industry changes, as regulators look at thrift books heretofore unavailable, as they seek changes in their approach to dealing with insolvent thrifts and as the real estate market fluctuates, the cost and asset values of savings and loan institutions will continue to change, and the cost to the taxpayers will change accordingly.

Mr. Chairman, I think it's unfortunate in a way that this committee does not have jurisdiction over the regulatory aspect of this problem, but the Congress must come to grips with this and must actively pursue cleaning up the situation that already exists and taking measures to prevent its occurrence in the future.

Today, the Treasury will give us their latest best estimates, but as Secretary Brady has said on a number of occasions in the past, the best estimates we will ever have will be only ranges of numbers until someone can pinpoint the behavior of the real estate market.

I look forward to hearing the Under Secretary's testimony today, and welcome him before our committee.

Chairman ROSTENKOWSKI. Any other members?

Mr. DOWNEY. Mr. Chairman, in my earlier incarnation, I was a member of the Armed Services Committee, and we fairly routinely heard from people testifying on the expenses of weapon systems.

And they would assure us that the cost was not going to escalate, and then a year later, the cost had gone up. They said there were a whole variety of factors, unknown at the time, that required the cost estimate to change.

This is becoming painfully like those days of big weapon systems that went out of control, and I hope that finding accountability is not partisan bickering and that attempting to assess what will happen is not shooting the messenger.

I don't know Under Secretary Glauber, and I am sorry that you have to be the messenger that is going to receive some of these bashes. My guess is that you have worn an appropriate suit of armor today, but the people on Long Island are very concerned.

They stop me in pizza places, they stop me on the street, and they not only want to know how much this is going to cost them, but why it happened.

And I cannot tell them. I don't have the answers I would like to give them, like how much it's going to cost because that keeps changing.

And what disturbs me the most, the chairman of this committee and the vast majority of the members of this committee last year wanted to see the financing of this program put on budget and outside Gramm-Rudman. And it appears now that that is what the administration's position is. Why the sudden change?

I want to hear why it is that there are—what we were advocating last year was impossible to do then, but now is OK. And I want

to issue this one warning and maybe it will get taken back to the Treasury Secretary.

I don't know how you are going to pass, or this Congress is going to pass, more borrowing for the Resolution Trust Corporation because Members of Congress are deeply concerned about what happened.

And the last thing, the last thing that most of us want to do is pour more money down a rat hole. And this appears to be one that is cavernous.

But having said that, I don't want to pass the cost onto my children and my grandchildren. I don't want to spend 20 or 30 years resolving the mistakes of the last 10. So it's with those concerns in mind, Mr. Chairman, that I will listen very carefully to the Treasury witnesses and want to know why they have suddenly decided to take the advice that they spurned last year, and hopefully I will be listening very carefully if they can give us some sort of estimate as to what this ultimately will cost us.

Mr. STARK. Thank you, Mr. Chairman. I would like to take a shot at the person that sent the messenger and indicate that we knew this bad news was coming for years. And I personally did not think it was a profile in courage for the President to say after we got trillions of dollars of debt that he is willing to consider taxes.

We are so proud of the progress that this administration has made in Eastern Europe and in negotiating with the Communists all over the world. It makes us proud to be Americans.

Now we are going to have to show that this system works. We haven't the slightest idea as to what the President intends to do relating to the savings and loan crisis. The Congress is responsible, several administrations are responsible, but he is the leader.

We have a summit meeting, and I don't think that we should be wrestling with each other as to who is going to be the one that is going to take the political hit, whether it is the Congress or the President.

This is a time to show the Communists and the rest of the free world that we have a leader. And I don't know whether these summit meetings are provided for in the Constitution. I worked hard to get on this committee, and to get to the Congress, but I know that we are going to get a package from somebody indicating what has been decided.

Why can't the President tell the entire country the direction in which he would want the people to go, the Congress to go, the summit to go, rather than have us go through these exercises in taking out the checkbook and saying, go ahead and continue to do what you are doing.

So I hope, Mr. Messenger, that you might tell the President that we are entitled to more than just increase in the debt limit and that it's time for him to do more than just tell us to read his lips or what he would consider the American people, and this Congress, Republican and Democrats, are prepared to make sacrifices.

But we need a leader, and we cannot legislate that.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Matsui.

Mr. MATSUI. I would only like to make a couple of observations.

I was going to refrain from making any comment at all, knowing the difficulty the witness has appearing before us this morning. But after hearing the ranking member's comments, I just feel that it's necessary to make some observations.

Nobody wants to shoot the messenger, and nobody wants to make a partisan political issue out of this matter. But I remember 1979 and 1980, when the tables were turned, when we had a Democratic President who had a $40 billion per year deficit.

We heard just the opposite on the other side of the aisle, and I have to say that perhaps it's a little hypocritical in 1990 now, after we have tripled the national debt over the last 10 years with a Republican President, that all of a sudden now we want to be statesmen.

And second, I would like to make the observation that the administration came in with $100 billion deficit in February of this year when they wanted to look good, and all of a sudden now they are up to $160 billion, a 60-percent increase.

And if we look at our Ways and Means staff document, we are seeing that during the next fiscal year we will be raising the national debt by some $250 billion, and in 1992, some $300 billion.

It's pretty obvious that the administration does not have the will to do much about this.

Third, I would like to just make one other comment in terms of the hypocritical comment that I heard on the other side of the aisle.

When the President did show some leadership and talk about the issue of taxation, we saw immediately 90 Members on the other side of the aisle writing letters to the President saying, we don't want to see any revenue increases.

And, you know, if we want to talk seriously about deficit reduction, we ought to begin to realize what we are saying ourselves.

Chairman ROSTENKOWSKI. Mr. Gibbons.

Mr. GIBBONS. I will be very brief. I have just a message for the messenger. You are asking for $700 billion, approximately, increase in the debt ceiling over a 2-year period. I assume you are assuming that our debt is going to go up by $700 billion during that time.

Second, we have two problems. The paper you have submitted adequately outlines the problem. I think all of us understood that; we have understood it for years. But the second problem is the one created by the President. He convinced the people that you didn't need taxes. Does he want to borrow his way out of this? That seems to be what he is proposing here.

If so, I have a message for him. I am not going to allow any more borrowing as far as I am concerned.

Chairman ROSTENKOWSKI. Mr. Glauber.

STATEMENT OF HON. ROBERT R. GLAUBER, UNDER SECRETARY FOR FINANCE, U.S. DEPARTMENT OF THE TREASURY

Mr. GLAUBER. Chairman Rostenkowski, Mr. Archer and members of the committee, I appreciate the opportunity to appear before you today to advise you of the need for congressional action to increase the debt limit before the scheduled August congressional recess.

Treasury's current estimates show that the permanent ceiling of $3,122.7 billion will be sufficient only until mid-August. Without an increase in the debt limit, it appears likely that the Treasury will run out of cash and borrowing authority and default on the Government's obligations in mid-August. It is highly likely that default would occur before Congress returns in September.

Our estimates are subject to a greater-than-usual degree of uncertainty, because the Resolution Trust Corporation (RTC), which borrows from the Federal Financing Bank (FFB), faces difficult in predicting the timing and level of its need for working capital funds. A significant near-term increase in RTC spending above the current estimate could accelerate the need for an increase in the debt limit to early August in order to invest the Social Security trust funds fully.

As you know, the limit usually is raised to a new permanent level sufficient to fund the Government's needs for the coming fiscal year. We estimate that a debt limit of $3,509 billion will be sufficient to last through fiscal year 1991.

Since the debt subject to limit is expected to hit a peak level on September 2, 1991, when the normalized tax transfer to the Social Security trust funds is invested, this figure includes an extra $30 billion allowance above the $3,479 billion of debt subject to limit estimated by OMB in the Mid-Session Review.

In the spirit of the longer term horizon for reducing Federal budget deficits in bipartisan negotiation on the budget, it is appropriate at this time to consider increasing the permanent debt limit in an amount that is sufficient for the next several fiscal years. In this connection, the administration's current estimates indicate a debt limit need of $3,811 billion through fiscal year 1992, including an allowance of $35 billion for Social Security trust fund investments in early September 1992, and $4,053 billion through fiscal year 1992, including an allowance of $40 billion for trust fund investments in early September 1993.

These figures include the revisions of the RTC's financing needs discussed below, and they are consistent with the Mid-Session Review of the budget for fiscal year 1991, which is due for release by OMB on July 16. Since the Mid-Session Review will not be released until next week, I am not able to provide more detailed information on the specific receipts and outlay estimates that underlie the debt limit figures.

I should note, however, that RTC outlays, which are subject to substantial forecast uncertainty, play a large role in the overall outlay figures. Depending on actual RTC experience, we could reach the debt limit before or after the end of the fiscal years indicated.

If Congress were to leave for its August recess—scheduled for August 6 through September 4—without increasing the debt limit, the Treasury would likely default on $20 billion of notes maturing on August 15 and be unable to make interest payments totaling $21 billion that day. Also, the United States most likely could not honor, on August 31, $3 billion of military retirement and salary payments or payments totaling over $11 billion to Social Security and supplemental security income recipients, railroad retirees and veterans.

Defaulting on obligations already incurred is very different from halting operations of the Government where spending authority is allowed to lapse, such as occurs when appropriations are delayed. Once an obligation is incurred, it must be paid.

Finally, default would have very serious adverse consequences on domestic and international confidence and trust in the United States.

I want to turn now to the financing needs of the RTC, in response to questions that have been asked by this committee. We have attached for your information Secretary Brady's June 14 testimony before the House Committee on Banking, Finance, and Urban Affairs, which gives a more complete response to the questions you asked regarding cost of the thrift clean up.

First, the original cost estimates. The $50 billion provided to the RTC for thrift losses in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) was based on the most credible estimates at the time, prepared by the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the General Accounting Office. All three of these agencies estimated that $50 billion would be sufficient to meet the RTC's needs.

However, as we said during the legislative process, the level of resources needed, no matter how thoroughly researched or widely agreed upon, was still based only on estimates. Uncertainties included the level of interest rates and the strength of the economy, the timing and amount of asset sales, as well as many other factors that could have a significant impact on the size of the problem.

Revised estimates. Actual experience over the past 10 months indicates that RTC losses have increased because: The losses in individual thrifts are larger than expected; marginal thrifts are likely to fail sooner than expected—becoming the responsibility of the RTC, not the Savings Association Insurance Fund—and the total number of projected thrift failures has increased.

A number of factors have contributed to these higher projections. The population of thrifts which has become the responsibility of the RTC has been in worse financial condition than anticipated. Until the RTC was able to get inside these institutions, it could not make an effective evaluation.

There has been a general decline in regional real estate markets, particularly commercial real estate, in many parts of the country. Unfortunately, RTC thrifts' assets are heavily concentrated in real estate, whether through direct investments, foreclosed property, or real estate loans.

Interest rates, which are now higher than we had projected, have increased operating losses for thrifts in conservatorships and caused softer real estate markets.

And finally, there have been unexpected losses in below-investment grade bonds, sometimes referred to as "high yield" or "junk" bonds—RTC currently owns $4 billion of junk bonds in its portfolio.

Again, all of these factors have produced not only higher than expected losses, but also an increase in the population of savings and loans that will require attention.

When will more funding be needed? Even though the RTC has spent only about half of the $50 billion provided in FIRREA to cover losses, it could, with an aggressive schedule of case resolu-

tions, run out of loss funds by the end of this calendar year. However, the RTC faces another important constraint in the form of the obligation limitation included in FIRREA. This is the provision which limits RTC obligations—most notably, working capital borrowings—to the amount of unused REFCORP authority, cash on hand, and 85 percent of the fair market value of assets held by the RTC.

Based on its current method of calculating the working capital obligation limitation, the RTC will run up against that limitation sooner than it uses the $50 billion to cover losses—almost certainly not later than early in the fourth calendar quarter of this year. If the RTC cannot raise additional working capital and the cost of acquiring assets exceeds the amount generated from sales, it cannot proceed with resolutions. To assure that the pace of resolutions is not constrained by the availability of funds, and that the cost to the taxpayer is not increased by the consequent delay, it is essential that the RTC receive increased funding by the end of the third quarter, that is, by September 30, 1990.

How much more will be needed? There are too many variables to pick a single number; number of cases, losses on assets, interest rates, and market conditions, among others. The most responsible course, we believe, is to consider a range of possible outcomes.

Taking into account all of the uncertainty and all of the variables, it appears that the cost, in present value terms, of resolving institutions which are likely to come under the control of the RTC will be in the approximate range of $90 billion to $130 billion.

Any attempt to convert these present value costs to yearly expenditures must incorporate an additional factor, the pace at which the RTC can resolve institutions. This greatly affects the amount of RTC outlays on a yearly basis, but has relatively little impact on the overall size of the loss.

A representative range of the resources the RTC may need in fiscal year 1991 to cover losses should be from slightly over $30 billion to slightly over $50 billion. We estimate that working capital needs would be from $20 to $40 billion.

How should additional funds be raised? The Federal home loan bank system simply does not have the financial capacity to back substantially more Resolution Funding Corporation (REFCORP) borrowing than was provided for in FIRREA. Additional resources will have to come from Treasury funds.

The form of additional financing, there appear to be two basic choices for how the funds should be provided: Either through appropriations to RTC of specific amounts from time to time to cover some or all remaining losses, or through an appropriation to the RTC of such sums as are necessary to complete the job. No matter which way the funds are provided, the cost of resolving the savings and loan crisis will not change. Moreover, it must be emphasized that this is not a discretionary activity; the Government's deposit guarantee must be fulfilled.

There is precedent in the Federal budget for providing indefinite authority for funding mandatory activities. In addition, Congress will have plenty of oversight regarding the RTC's use of the funds provided, since the Oversight Board and the RTC must report to Congress on a regular basis.

Mr. Chairman, this completes my formal statement. I will be happy to answer the committee's questions.

[The statement that Secretary Brady submitted to the House Committee on Banking, Finance, and Urban Affairs on June 14, 1990, follows:]

**STATEMENT OF SECRETARY NICHOLAS F. BRADY
ON BEHALF OF THE OVERSIGHT BOARD OF THE
RESOLUTION TRUST CORPORATION**

Mr. Chairman, members of the Committee,we are pleased to have this opportunity to present our views on the progress to date under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and to discuss the outlook for the months to come.

I address the Committee this morning in my capacity as Chairman of the Oversight Board and am accompanied by three other members of the Board: Chairman Greenspan, Secretary Kemp and Robert Larson. Our fifth member, Philip Jackson, Jr., is out of the country and unable to join us today.

We are also accompanied by William Taylor, who has served for the last several months as the Acting President of the Oversight Board, and Peter Monroe, the incoming President.

Speaking for a moment for the three charter members of the Board, let me tell you how pleased we are to have been joined by two such able individuals as Philip Jackson and Bob Larson. We are all grateful for their willingness to sign on and of course for their experience and judgment.

This testimony will cover our efforts since the enactment of FIRREA ten months ago. We are dealing with a moving target, made greatly more expensive by a weakening real estate market and constantly changing economic conditions. It is not susceptible to easy answers or simple solutions. The problems are complex and massive -- as we knew they were a year ago as we worked together to adopt legislation. If anything, the experience of ten months has revealed that the task is even more formidable than any of us then imagined.

As we proceed, we do so under three principles which have guided us from the start:

-- First, we will make sure that the millions of men and women who put their life savings in savings and loan institutions are protected to the full extent of their federal deposit insurance.

-- Second, we will do all within our power to do the job at the least cost to the taxpayer.

-- Third, we will aggressively pursue and prosecute the crooks and fraudulent operators who helped create the S & L problem.

It is important to bear in mind that money spent on the savings and loan crisis is spent with a single purpose in mind. The United States government made a promise to millions of Americans. We promised to protect their savings if deposited in a federally-insured savings and loan. Now we make good on that promise.

We are not using taxpayer dollars to bail out any thrift institution, their owners, or the savings and loan industry in general. We are living up to the government's end of the agreement represented by federal deposit insurance.

There are many who are impatient to wish these unpleasant problems behind us. We must remember, however, that it took over a decade for the thrift problem to become so costly and so difficult to fix. The enactment of FIRREA less than a year ago was only the beginning of the solution; we still have a long way to go before we reach the end.

There are no magic solutions. We cannot predict with certainty the amount of money or the amount of time it will take to finally resolve this problem. What we can promise is to seek sound advice, use common sense, and see that the problem is effectively managed.

Our statement first takes a brief look back at the circumstances which led up to the enactment of FIRREA. It then provides a report on progress from last August to the present, covering the following areas: case resolutions; assets acquired and sold; enforcement efforts; affordable housing; and minority outreach. We address in this progress report several issues raised by the Committee in addition to housing and minority programs: the conservatorship program; quarterly operating plans; status of the accelerated resolution and clean sweep programs; compliance with the Community Reinvestment Act. Finally, we look ahead to consider the question of resources.

Before we do so, we should face squarely the fact that the real estate market in a number of areas in the U.S. is in a weakened state and has become particularly so in the last year. This affects every aspect of the problem we face, especially the job of estimating the size of the problem. The condition of the real estate market affects the number of institutions which fail, the value of their assets, the speed at which assets can be sold, and thus, the ultimate loss.

FIRREA requires that we estimate the remaining exposure of the U.S. government from institutions which will come under the control of the RTC. We have attempted to do so in this statement, but note that such estimates are highly uncertain because they require market predictions, which are themselves highly uncertain. For that reason, no one should assume that the estimates presented today will not change. They will.

A LOOK BACK

The problems we are wrestling with today have roots which reach back over many years. They extend back to events of more than a decade, as the thrift industry struggled to cope with economic adversity and fundamental changes in financial markets; to broadened powers, coupled with insufficient policing by government regulators; to capital requirements which resulted in too little of thrift owners' money being at risk; to problems in real estate and the junk bond markets; and, in many instances, to mismanagement and misdeeds. Many of these problems flow together and feed on one another.

The savings and loan problem was there to greet President Bush when he took office in January 1989 and he wasted no time in responding. Less than a month after taking the oath of office, the President came forward with a plan and made it one of his highest priorities to enact it into law.

You in the Congress and we in the Administration worked together last year as architects of a plan to repair the damage and reform the system. Together we devised a plan to resolve the savings and loan crisis and to help prevent it from happening again. While comparisons with other government rescues are inevitable, this is not a bailout. We are not bailing out shareholders. We are not bailing out management. We are not in this to preserve institutions. In fact, many will be lost. It bears repeating that monies spent are to protect depositors.

It was just over a year ago that Congress took up consideration of FIRREA. Under your leadership, Mr. Chairman, and that of your Committee, the House of Representatives produced a bill in a timely manner. While preserving the essence of the Administration's plan, you added your imprint in areas such as capital requirements; affordable housing; the tightening of the qualified thrift lender test; purchased mortgage servicing rights; curtailing "junk" bond investments; open thrift assistance; the creation of the Federal Housing Finance Board; and the disclosure of Community Reinvestment Act ratings.

With the enactment of FIRREA on August 9, 1989, the machinery was put in place.

A PROGRESS REPORT

Under the provisions of FIRREA, the Oversight Board must report on case resolutions, costs incurred, and asset sales during the period from October 1, 1989 through March 31, 1990, along with providing certain other financial information. While reporting on the six-month period as required, we have not limited ourselves to that and, where possible, provide in this statement information on more recent RTC activities.

As we review the progress to date, it is important to remember that a key purpose of FIRREA is to provide the money and mechanisms to separate out insolvent and failing thrifts, so that the industry which remains can compete successfully and safely in the financial marketplace.

The evidence is that FIRREA is working. Based on fourth quarter 1989 figures, OTS has analyzed the thrifts which remain after removing the institutions already resolved, those currently at the RTC for resolution, and those likely to be sent to the RTC in the near future. The industry which remains is profitable, has on average more than three percent tangible capital, and is growing by adding deposits.

Case resolutions

When the RTC started its work on August 9, 1989 there were 262 institutions in conservatorship. Since August, the RTC has resolved 148 cases (including 28 between October 1 and March 31), while adding 181 institutions to the caseload. That left the RTC, as of June 8, 1990, in control of 295 conservatorships.

While there has been a great deal of discussion about the RTC's relatively slow start in case resolutions, progress in recent months has been substantial. The RTC has resolved nearly 100 cases in the last eleven weeks -- by any measure, a tremendous accomplishment.

To the extent that it took longer for the process to get under way than some expected or hoped, it was not for lack of resources. Immediately after FIRREA was signed, $20 billion was provided to the RTC in appropriated funds and industry contributions. The Resolution Funding Corporation has provided $13 billion. The Oversight Board acted in February to allow the RTC to borrow working capital from the Federal Financing Bank. The availability of those resources has ensured that no disruption has occurred for lack of resources.

One factor that certainly affected the pace of resolutions during the first several months is that it takes time to build an organization, particularly one so large and with so difficult a task as the RTC. I am surprised by those who so readily dismiss the difficulties of creating in just ten months an organization that is roughly the size of Citicorp.

RTC's concern about a pile-up of retained assets of failed thrifts seems to have been another factor affecting the pace of resolutions. Because of the difficulty of managing and disposing of assets, the RTC will attempt to pass as many assets as possible to private sector acquirers. We certainly share that goal, but have tended to support a quicker pace of resolutions, while moving on a separate track to return assets to the private sector.

At the request of the RTC, the Oversight Board in February approved a policy establishing a general limit of twelve months on the amount of time that an acquirer has to decide to put assets back to the RTC. This policy will give acquirers adequate time to get to review the assets of an institution without a lengthy period of review preceding the acquisition. The hope is that this will not only quicken the pace but also increase the likelihood that acquirers will take on assets.

The major problem faced by the RTC in trying to resolve cases, however, is that there simply have not been many interested buyers for the assets taken over, especially for whole thrifts.

Quarterly operating plans. With policies in place and the lessons of nearly eight months of operations, the RTC in March laid out an ambitious schedule of case resolutions for the third quarter of fiscal year 1990. The plan calls for resolving 141 institutions with assets totalling nearly $50 billion between April 1 and June 30, 1990.

The Oversight Board endorsed the third quarter plan and approved the funds necessary to carry it out. The plan approved by the Oversight Board provides for up to $51.6 billion in spending on case resolutions during the quarter, of which $19.1 billion represents estimated net losses and $32.5 billion the recovery value of receivership assets.

As of June 8, the RTC had resolved 96 of the 141 institutions with assets of $21.2 billion. Although a substantial amount of work remains to be done, we are advised by the RTC that they expect to hit the target of 141 resolutions by the end of the month.

Whatever the final number, the RTC deserves enormous credit for its accomplishments during the third quarter. This represents a significant achievement by historical standards.

Of the 141 institutions targeted for resolution during the current quarter, the RTC identified about 50 which would be resolved either through insured deposit transfers or payouts. This part of the plan was labeled "Operation Clean Sweep" (though many people use the term to describe the entire third quarter program). We have encouraged the RTC over the past several months to place greater reliance on liquidations and were therefore pleased to see the emphasis on this method of resolution in the third quarter.

Of the 96 third quarter resolutions through June 8, there have been 38 purchase and assumption transactions involving institutions with assets of $15.0 billion; 46 insured deposit transfers involving institutions with assets of $5.2 billion and 12 payouts involving institutions with assets of $1.0 billion.

The Oversight Board is involved in ongoing discussions with the RTC about projections for case resolutions during the quarterly periods beginning on July 1 and on October 1 of 1990. However, no operating plan has yet been presented or adopted for those quarters. Spending requirements will be driven by the pace of resolutions, which we would describe in terms of asset values rather than the number of institutions. It seems reasonable to expect that the RTC could resolve institutions with assets ranging from $20 billion to $40 billion per quarter.

We recognize that both the Congress and the Administration have a need for information about RTC spending plans. We hope to move toward planning for six-month periods and will work with the RTC to achieve that end.

Conservatorship program. As of June 8, 1990, there were 295 thrifts in conservatorship. It is impossible to say how many more will enter the program. The Office of Thrift Supervision (OTS) has identified 299 institutions which, as of April 27, 1990, were likely candidates for resolution and another 315 for which the future is uncertain. The number of failing thrifts which ultimately enter conservatorship also depends on the number that receive some form of expedited resolution, bypassing conservatorship altogether.

The benefit of placing an institution in conservatorship is that it allows the government to stem losses and bring to a halt practices which may have contributed to the insolvency. Once an institution has been taken over, the RTC reduces its risk exposure and prepares it for resolution. This includes reducing the asset side of the balance sheet through the packaging or securitization and sale of financial assets.

The problem with placing an institution in conservatorship -- particularly for an extended period of time -- is that it generally leads to a further erosion in franchise value. For example, the trained staff of a thrift in conservatorship may worry that it will be liquidated and opt to take jobs elsewhere.

We recognize that the General Accounting Office has raised concerns about the training and turnover of managing agents. Given the size and the unprecedented nature of the conservatorship program, it should come as no surprise that there may be operating difficulties in the field. The Oversight Board intends to monitor the situation and provide policy guidance as warranted.

Accelerated resolutions. We are concerned about the effect of the conservatorship program -- in essence, the government warehousing of private sector assets -- on franchise values. The RTC shares these concerns and therefore has developed the idea of the "accelerated resolution program."

Under the accelerated resolution program, an institution will be marketed before it is actually placed in conservatorship by the Office of Thrift Supervision. The RTC, in cooperation with the OTS, is in the process of developing a pilot project to test this form of resolution. The Oversight Board will monitor the development of this program to ensure that it operates in a manner consistent with the requirements of FIRREA and the Strategic Plan.

While the details of the accelerated resolution program remain to be worked out, we support the goal of trying to deal with an institution when resolution costs the least. At the same time, however, we will continue to focus on the need to resolve the existing conservatorship caseload.

Community obligations. Enforcing an acquirer's obligations to its community and encouraging it to meet such obligations are essentially functions of the financial supervisory agency which regulates an acquirer. In enacting FIRREA, Congress recognized that such supervisory functions would not be exercised by the RTC:

> "Neither the Oversight Board nor the RTC, whether in its corporate capacity or in its capacity as conservator or receiver, act as a supervisor or regulator of insured financial institutions. The appropriate Federal bank regulatory agency retains such status for all purposes."

Under the Community Reinvestment Act, the community credit record of an institution that applies to acquire an RTC institution will be evaluated by the Federal financial supervisory authority that created such a record as part of its

examination of the acquirer. It is the responsibility of the supervisor to review a potential acquirer's community reinvestment record in considering the institution's application to acquire a failing thrift.

Assets acquired and sold

There are two groups of assets under the control of the RTC: those in conservatorship and those in receivership. As of March 31, 1990, there were 350 institutions in conservatorship with gross assets, in book value, of $159.9 billion (based on December 31, 1989 financial data). The composition of assets held at that time was as follows:

Table 1

CONSERVATORSHIP ASSETS
350 Conservatorships as of March 31, 1990
Book Value of Gross Assets

($ billions)

Cash and securities	$41.6	26%
Mortgages	$80.4	50%
Other loans	$13.5	8%
Real estate owned	$13.8	9%
Other assets	$10.6	7%
Total	$159.9	100%

The composition of assets under the control of RTC receiverships as of March 31, 1990 was as follows:

Table 2

RECEIVERSHIP ASSETS
52 Receiverships as of March 31, 1990
Book Value of Gross Assets

($ billions)

Cash and securities	$ 1.7	13%
Mortgages	$ 7.1	53%
Other loans	$ 0.9	7%
Real estate owned	$ 2.9	22%
Other assets	$ 0.7	5%
Total	$13.3	100%

The largest part of the RTC's asset disposition efforts has been sales from conservatorships. This follows from the guidance provided by the Oversight Board in the Strategic Plan, which provides "to the extent feasible and cost effective, the asset side of the balance sheet [of thrifts in conservatorship] should be reduced through the packaging or securitization and sale of financial assets."

While the RTC has compiled a substantial record on sales from conservatorships, there has been less progress in disposing of receivership assets. To some extent, this is understandable, because the receivership assets are the most troubled. The Oversight Board and the RTC, however, are anxious to establish a record of steady and solid progress in the sale of assets.

Table 3 shows the level of sales and other collections on assets held or managed by the RTC through March 31, 1990. It shows that, through March 31, 1990, the RTC has reduced the volume of assets under its control -- including both conservatorships and receiverships -- by $41.9 billion through March 31, 1990. We recognize that the most marketable assets are sold first, but we are nonetheless pleased to see this level of reduction.

Of the $173.2 billion in assets under the control of the RTC at the end of March (both in conservatorships and receiverships), $16.7 billion or ten percent was owned real estate. It is too early in the process to assess the impact of RTC real estate sales on local markets.

It becomes critically important to achieve greater progress in the area of asset sales as the number of resolutions increases. At the end of the second quarter of the fiscal year, the estimated fair market value of receivership assets totalled about $7 billion. Under the third quarter operating plan, that total could increase as high as $39.5 billion.

Table 3

Balances of Assets Held or Managed by RTC from Inception through March 31, 1990
402 Institutions *

($ in billions)

Asset Type	Beginning Conserva-torship	Reductions during Conservatorship			Resolution & Receivership Reductions			Balance at March 31, 1990	
		Sales Proceeds	Payments & Matur-ities	Other Changes (Net) **	Passed to Acquirer	Principal Collect-ions	Other Changes (Net)		
Mortgages	102.8	-2.3	-7.2	-1.8	-3.8	-0.2	0.0	87.5	
Other Loans	17.1	-0.4	-2.3	0.7	-0.9	-0.1	0.2	14.4	
Cash & Secur.	60.9	-14.8	-6.0	3.2	-1.0	-0.1	1.1	43.3	***
Owned Assets	16.3	-1.8	-0.1	2.4	-0.0	-0.1	-0.0	16.7	
Other Assets	17.7	-0.6	-0.3	-4.9	-0.6	-0.0	-0.0	11.3	
TOTALS	214.9	-19.9	-16.0	-0.3	-6.3	-0.5	1.3	173.2	

* At March 31: 350 Conservatorships
52 Receiverships

** Changes in Other Assets include charge-offs of certain intangible assets and equity investments

*** Includes approximately $1.1 billion in receivership cash available for the payment of expenses and dividends.

We must take advantage of the opportunity to dispose quickly of assets which have a ready market, such as single-family mortgages. With the encouragement of the Oversight Board, the RTC recently adopted a policy for providing representations and warranties, as are customary in the marketplace.

We also support the RTC in the procedures recently adopted for determining the market value of assets and establishing prices for sales by auction. We believe that the RTC Board has taken an initial step toward dealing with appraised values which may in some cases overstate market values and so communicated that to the RTC during its deliberations. We find the approach which they have taken to be responsible.

Last month, the members of the Oversight Board met with Chairman Seidman to discuss ways to expedite asset disposition.

Enforcement efforts

We must vigorously pursue those whose criminal and fraudulent activities helped create the current situation. As we observe the failed institutions and contemplate the mounting losses, we continue to be convinced that the government must provide the resources that are needed to make certain that those who have abused insured institutions know the effects of justice.

The RTC has established an Office of Investigations in Washington and has teams of investigators throughout the country. The RTC's investigations staff is planned to reach 300 by year end. These investigators will help to identify negligent and reckless mismanagement, fraud, and criminal conduct that contributed to thrift insolvencies. The RTC's investigators will be involved throughout civil litigation proceedings and also will assist the FBI and the U.S. Attorneys in criminal prosecutions.

Thrift regulators and institutions have made over 17,000 criminal referrals in the last three years. Over the same period, OTS and its predecessors required 664 institutions to enter into binding agreements terminating unsafe and unsound practices; removed over 150 senior officers and directors from thrifts and forbade them ever again to be employed by an insured thrift institution; and issued 111 cease and desist orders, to stop unsafe and unsound practices and to require restitution. In addition, there are over 1,000 civil law suits seeking to recover billions of dollars from the former directors, officers and professionals -- including accountants and lawyers.

Criminal referrals have already resulted in prosecutions and convictions. The Woody Lemons case in Dallas, Texas provides a dramatic recent example. Lemons, the former Chairman and Chief Executive Officer of Vernon Savings and Loan in Vernon, Texas, was sentenced to spend 30 years in prison, following his conviction for an elaborate bank fraud scheme, misapplication of Vernon's funds, and bank bribery.

As of May 11, 1990, the Dallas Bank Fraud Task Force, in which OTS and RTC personnel are working closely with the Department of Justice, has charged 70 defendants and obtained 49 convictions. That Task Force also has succeeded in having the courts impose criminal restitution orders of over $16 million.

Despite the extent of our present enforcement activities, the government needs to do more. To accomplish this goal, the Attorney General and I are working to see that financial misconduct is punished. We are establishing priorities for the major criminal referrals and civil cases of all financial regulatory agencies and are working with the Department of Justice to see that the most important criminal cases receive the priority attention they deserve.

Affordable housing

Since we last appeared before the Committee, the RTC has proposed and the Oversight Board has approved an interim rule for the Affordable Housing Disposition Program. This rule implements the provisions of FIRREA requiring the RTC to offer certain residential properties to qualified purchasers for a 90-day marketing period. The interim rule was published in the Federal Register on April 16, 1990, and the 60-day comment period is over tomorrow.

The development of this rule was a collaborative process between the RTC and the Oversight Board, as has been the development of a guideline for the disposition of properties having no reasonable recovery value. The guidelines will provide for the conveyance of such properties to be used as shelter for the homeless, housing for lower-income families and other public uses.

In March, the Oversight Board approved a policy encouraging the RTC to enter into agreements with state and local housing finance agencies to provide low-interest financing for RTC affordable housing properties. Pursuant to that policy, the RTC has entered into commitment agreements in Arizona and Texas and is negotiating for reservations of funds in other key states. The Oversight Board authorized the RTC to spend up to $6 million during fiscal year 1990 to pay commitment fees for bond programs, which could reserve funds to finance the sale of more than 6,000 properties.

The first use of this program will be in Texas, where the state housing agency is expected to issue $140 million in bonds during the next few days to fund approximately 3,500 homes at an expected interest rate of about 8.5 percent. Under the proposed commitment agreement between the RTC and the Texas Housing Agency, the RTC has identified 2,000 homes that are immediately ready for sale and that meet minimum property standards for insurability. The RTC also has committed under that agreement to make ready for marketing a minimum of 4,000 additional homes during the next year.

Approximately 84 percent of the homes currently in the affordable housing inventory are appraised at $50,000 or less and the average appraised value is less than $35,000. With low-interest bond financing, a $50,000 home is affordable to a family with an income of about $18,500, or about 53 percent of median income in Texas, based on standard loan underwriting criteria. This suggests that the affordable housing program will be able to serve the needs of a broad range of lower-income families, not just those at or near 115 percent of median income.

A major obstacle to implementation of the affordable housing program has been the sheer difficulty of getting thousands of small properties ready for sale. For each property, someone must order an appraisal, authorize necessary repairs, select and contract with a broker and notify the clearinghouses. Since asset management contractors have not yet been selected in large numbers, the RTC's limited staff has performed these jobs on the initial properties. As institutions are resolved and private sector asset managers are selected and placed under contract, the flow of properties into the program is expected to increase dramatically.

We have included as an attachment to this statement a listing of the 100 single-family properties offered for sale under the first phase of the program, along with information about the property and buyers. In addition, we understand that the RTC will be releasing its second inventory of property this week, which will again include a listing of all properties eligible for the affordable housing disposition program.

The RTC has recently reported to the Oversight Board on its experience with the initial pilot program involving the marketing of 100 single family homes in 11 states. Though the report is based on very limited experience, the RTC has offered a number of observations about the program.

First, the income of purchasers ranged from 30 to 115 percent of median, with an average income at 83 percent of median. Second, prearranged financing through bond or other programs helps to facilitate sales. Third, repairs are needed in most cases (about $1,000 per unit) to bring the properties up to standard. Finally, condominium units and duplex and triplex properties -- which represent a sizeable portion of the inventory -- present particular financing and marketing problems.

As you know, the Strategic Plan did not provide for the immediate use of direct subsidies such as price discounts and concessionary financing. Given the composition of the affordable housing inventory, it now appears that a wide range of lower-income families will be able to buy these properties without RTC subsidies. Nevertheless, the Oversight Board has had the issue of subsidies under study for several weeks and is examining various options.

We hope over the near term to see a rapid increase in the number of properties made available under the affordable housing program. We expect to see those homes sold to the intended beneficiaries of the affordable housing program. The Oversight Board will continue to monitor the affordable housing program carefully and will take the steps necessary to assure that the affordable housing objectives of FIRREA are met.

Minority outreach

The minority outreach efforts of the RTC fall into two major categories: outreach to minority and women contractors and preservation of minority- and women-owned institutions.

The RTC is developing its final policies and procedures for contracting with minority contractors. Thus far, the RTC has concentrated on getting eligible minority contractors registered. Of the 5,378 contractors that registered with the RTC 1,101 or 20 percent are firms that are owned by minorities and/or women. The RTC has continued to conduct workshops and seminars around the country to promote and provide information about the outreach program.

This registration program represents a critical element in RTC's minority outreach efforts, because it forms the basis for the selection of contractors. The RTC will solicit qualified contractors on a generally random basis, but will include at least one minority or women-owned business or joint venture (unless none has indicated the capability for the specific undertaking).

Based on preliminary data from the first quarter of calendar year 1990, approximately 206 or 15 percent of the 1,411 contracts awarded by the RTC receiverships have been to minority- and women-owned businesses. These contracts represent about $3.9 million of the approximately $25.3 million in total estimated contracting fees.

The Oversight Board is in the process of developing its own regulation applicable to its contracting activities to ensure that firms owned by minorities and women are given the opportunity to participate fully.

The second major area of outreach is an effort to facilitate the continuation of minority institutions, as directed by FIRREA.

The Oversight Board has authorized the RTC to postpone closing a transaction for up to nine months or provide bridge financing for the same duration in order to assist minorities acquiring minority institutions.

There are presently 14 minority thrifts in conservatorship. As of June 12, the RTC has resolved 6 other minority owned institutions. Two of the black-owned institutions were sold to a black-owned bank and another minority thrift was sold to a minority-owned bank. (Only one minority institution has been liquidated). The RTC has provided a loan to a minority acquirer to facilitate the acquisition of another minority institution.

The Oversight Board will supplement these efforts through a program of information and outreach to minority- and women-owned organizations. On a quarterly basis information will be provided to the appropriate organizations which lists all the institutions in conservatorship and identifies those which are minority-owned.

FUTURE REQUIREMENTS

Since the thrift crisis first emerged, there have been a number of sources providing explanations and estimates of the size of the problem. Each has a projection as to how many thrifts will require government expenditures and how much the entire cleanup will cost.

Some give cost estimates on a present value basis while others give them on a cash basis. Some estimate total costs for resolving the thrift crisis, while others focus on additional funds required.

Estimates also vary on whether they include REFCORP interest costs, interest on working capital, and even the effect on government borrowing costs. Including interest costs treats the savings and loan program differently from other government programs and has the effect of dramatically increasing cost estimates.

In short, there are a myriad of estimates prepared using a variety of methods. Of course, the highest estimates get the most attention. Let me give you our view of where things stand.

FIRREA established a funding structure which has three parts. First, it provided for the payment of prior commitments of FSLIC from the old FSLIC fund, anticipated insurance premiums from SAIF members, other revenues received by FSLIC, and, as a last resort, Treasury funds. At the time FIRREA was signed into law, it was estimated that the cost of winding down FSLIC, in present value terms, would be about $40 billion. Given market conditions, it now appears that the cost will be higher than originally estimated.

FIRREA requires the RTC to review all of FSLIC's 1988 assisted thrift acquisitions and report to Congress and the Oversight Board. Under the Strategic Plan, the report is to be completed by August 31, 1990. At that time, we will be better able to evaluate the long-term cost of these cases and to pursue modifications where savings would accrue.

Second, FIRREA provided $50 billion ($18.8 billion in appropriations, $1.2 billion from the Federal Home Loan Banks, and $30 billion from REFCORP) to resolve the RTC caseload -- that is, insolvent savings and loans which fail during the three years subsequent to the enactment of FIRREA.

At the time FIRREA was enacted, there were approximately 350 insolvent thrifts with assets of about $170 billion and roughly

another 150 institutions with $100 billion in assets that would almost certainly become insolvent in the near term. The $50 billion requested was based on the most credible estimates at the time, prepared by the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the General Accounting Office.

Finally, FIRREA established the Savings Association Insurance Fund (SAIF) to bear the cost of thrift failures which occur after August 9, 1992. Though we did not have a firm estimate of the funds that would be required by SAIF to meet its obligations, FIRREA authorized the Treasury to provide up to another $32 billion for this purpose. The present value of these future commitments is $23 billion.

At the time of the legislation, there was a great deal of uncertainty about the long-term cost of fixing the problem. The Administration stated repeatedly in letters and testimony that we could not say precisely which or how many institutions would fail, the nature and quality of their assets, what it would take to resolve them, how the performance of the economy and the real estate market would affect costs, or where interest rates would be -- all key variables in estimating the cost. Those same difficulties exist today.

To further illustrate this point, let me quote from a letter which I sent to the Chairman of the Senate Banking Committee, dated June 23, 1989, in response to his question about the adequacy of funds to be provided in FIRREA:

> "Let me emphasize ... that this level of resources, no matter how thoroughly researched or widely agreed upon, is still based only on estimates. Uncertainties include the level of interest rates, the strength of the economy, as well as many other factors that could have a significant impact on the size of the problem. As a result, the actual cost of case resolutions could be higher or lower, depending on the actual circumstances."

As of June 8, there have been a total of 443 thrifts with $222 billion in assets placed in conservatorship. The RTC has resolved 148 cases for which the estimated loss totals about $18 billion. In other words, the RTC has incurred losses equal to about 36 percent of the $50 billion provided in FIRREA.

If the RTC were to resolve all 141 institutions planned for the third quarter of fiscal year 1990, estimated losses would accumulate to $28.3 billion by June 30. At that point, there would be roughly 250 institutions left in conservatorship, plus additional thrifts which come under the RTC's control.

When we appeared before you in January, we stated "when we became convinced that additional resources are necessary to continue the program, we will request them in a timely manner." It is now clear that the amounts projected and authorized for the RTC in FIRREA will fall short of what is required.

The causes of these increased RTC losses appear to fall in three different categories: the losses in individual thrifts are larger than expected; marginal thrifts are likely to fail sooner than expected (becoming the responsibility of the RTC, not SAIF); and the total number of projected thrift failures has increased.

Why has this happened? We believe the answer lies in a combination of the factors causing uncertainty. The fact is that we now have what we simply could not have had at the time FIRREA was considered and enacted -- actual experience with the cost of marketing insolvent thrifts and their assets. This experience with 148 resolutions has made us more pessimistic about losses embedded in thrifts both inside and outside the RTC's current caseload.

A number of factors have contributed to these higher projections, including ones with which this Committee is very familiar. The first is a general decline in regional real estate markets, particularly commercial real estate. This has been true not only in the southwest, but in the northeast, southeast, and other parts of the country. Unfortunately, thrift assets are heavily concentrated in real estate, whether through direct investments, foreclosed property, or real estate loans. FIRREA sharply curtailed the amount of commercial real estate activities that thrifts can engage in going forward, but obviously, it could not address the losses already embedded in troubled thrifts.

A related concern involves the institutions that we expected would be the primary purchasers of thrift deposits and thrift assets -- other depository institutions. It's no secret that healthy banks and thrifts have become much more leery about taking real estate assets onto their balance sheets in view of current market conditions. Unfortunately, that is exactly what the RTC is trying to sell to them. The result has been few "whole thrift" transactions, where both good and bad assets pass to an acquirer, and few transactions where the acquirer takes any bad assets. This means more bad assets piling up at the RTC with lower expectations of the ultimate revenues they will produce.

A third factor is interest rates, which are now higher than we had projected. That translates directly into increased operating losses for thrifts in conservatorships and indirectly into softer real estate markets, since interest rates always play a key role in that sector of the economy.

A fourth factor is unexpected losses in below-investment grade bonds, sometimes referred to as "high yield" or "junk" bonds. As you know, FIRREA required thrifts both to divest these bonds and to carry them on their books at market value. The market for these bonds has dropped off substantially in recent months, and virtually all of the major thrift holders of these bonds have been taken over by the RTC. The result is that the RTC is now one of the largest owners of junk bonds, with some $4 billion in its portfolio, and it could end up with substantially more. At the same time, we just don't know exactly how much these bonds will be worth when they are finally sold.

A fifth factor is that, at least for some purchasers, thrifts just are not as attractive a franchise relative to banks as they once were. This is true in part because it is no longer possible either to run a thrift with low capital or to invest insured deposits in risky activities like direct real estate investment. That is as it should be, since it was activities like these that helped cause the problem.

But other restrictions imposed by FIRREA that are unrelated to safety and soundness, like the tighter qualified thrift lender test, may have also reduced the value of the thrift charter. However, it is too soon to say by how much.

Again, all of these factors have produced not only higher than expected losses, but also an increase in the population of savings and loans that will require attention. To some extent, this results from the fact that cases which we expected to be handled in the future by SAIF -- and for which FIRREA provided $32 billion -- will in fact be handled by the RTC. These cases are merely moving forward in time.

When will more funding be needed? Even though the RTC has committed only about a third of the $50 billion, it could, with an aggressive schedule of case resolutions, run out of funds by the end of this calendar year or early next year. If progress occurs at a slower pace than we would hope, RTC resources will last longer.

Of course it would be possible to slow the pace on the hope that market conditions will improve in the future. We believe that there has been too much speculation already. Our job is to be steady, do the work, and take no further gambles with the taxpayers' money.

How much more will be needed? As we have discussed, there are too many variables to pin a single number on it -- again, number of cases, losses on assets, interest rates, and market conditions, to name a few. The most responsible course, we believe, is to consider a range of possible outcomes.

OTS has indicated that there are some 299 institutions with assets totalling $193 billion which are likely candidates for transfer to the RTC. It should be noted that the OTS figures are as of April 27, 1990 and include 30 institutions (as of June 8) which have since come under the control of the RTC. We cannot say for sure how many more of this group will have to be resolved by the RTC.

There are another 315 thrifts with $152 billion in assets for which the future is uncertain but which currently have positive tangible net worth and do not require assistance. We simply do not know which and how many of these institutions will come to the RTC and what condition they will be in when they get there.

In short, at this point in time, the number of institutions which the RTC will have to resolve is simply unknowable. Yet this number drives the cost estimate.

Another source of uncertainty is the level of loss incurred by the RTC on institutions which come under its control. Losses in turn depend on a variety of factors which are difficult to predict. What will be the condition of institutions taken over by the RTC? How many will be resolved on a whole thrift basis and how many clean?

The more liquidations and clean thrift resolutions that the RTC does, the more assets it must sell and the more uncertainty there is about losses. The discount which the market places on assets will vary by category. For example, performing mortgage loans generally can be sold for a higher percentage of their book value than can owned real estate. In the end, the loss rate on assets will depend on unpredictable factors such as market conditions, including the state of the real estate market, and interest rates.

This is clearly a formidable list of factors, each of which can substantially affect the total cost of resolving the RTC's caseload of institutions. For example, a reasonable lower limit on the number of institutions which will have to be resolved, together with small, medium, and high levels of losses on selling the assets of these thrifts, produce cost estimates (in present value terms) of $89 billion, $97 billion, and $114 billion.

For reference, the estimates in this statement should be compared with $73 billion provided in FIRREA. In other words, they include the $50 billion provided for the 1989-92 period and the $23 billion (in present value terms) provided for the succeeding eight years.

The same loss factors applied to a reasonable upper limit on the number of institutions to be resolved yields cost estimates (in present value terms) of $99 billion, $113 billion, and $132 billion. Again, these figures should be compared with amounts already provided by FIRREA, not added to them.

Of course, one could make even bleaker assumptions and make an estimate based on even higher populations of failed thrifts

and even higher loss factors. This would dramatically increase the top range of the cost estimate. While such an scenario is theoretically possible, we believe it to be quite unlikely under any reasonable set of economic conditions.

As has become the convention, all of these estimates are given in present value terms. Presenting estimates in constant dollars allows us to compare better, but admittedly does also produce a lower total than nominal dollar estimates.

Any attempt to convert these present value costs to yearly expenditures must incorporate an additional factor, the pace at which the RTC can resolve institutions. This greatly affects the amount of loss which the RTC must absorb on a yearly basis. A representative range of the resources the RTC may need in fiscal year 1991 would be about $30 billion to slightly over $50 billion, excluding working capital. FIRREA already provides some of these resources to fund losses through REFCORP.

The other major source of uncertainty in measuring the yearly effect of RTC spending is of course working capital. We have provided the RTC access to working capital through the Federal Financing Bank. When the RTC uses these borrowed funds to acquire assets, it counts in the budget as an outlay; when assets are sold, it counts as a receipt. Thus RTC's short-term borrowing requirements will result in enormous budgetary swings and distort the true picture of the deficit.

All of this suggests that there are too many unknowns to provide a single estimate of the ultimate cost. Taking into account all of the uncertainty and all of the variables, it appears that the cost of resolving institutions which are likely to come under the control of the RTC will be in the approximate range of $90 billion to $130 billion. Once again, these figures are in present value terms and include the $73 billion provided in FIRREA ($50 billion for 1989-92 and $23 billion for future SAIF cases).

How should additional funds be raised? The Federal Home Loan Bank system simply does not have the capacity to back substantially more Resolution Funding Corporation (REFCORP) borrowing. Additional resources will have to come from the Treasury funds.

Finally, how should the funds be provided? There appear to be two basic choices: either provide a specified amount to cover some or all remaining losses or provide the RTC such sums as are necessary to complete the job. No matter how the funds are provided, it will not change the cost of resolving the savings and loan crisis. This is not a discretionary activity; the government's deposit guarantees must be fulfilled.

There is precedent in the federal budget for providing indefinite authority to fund mandatory activities. Congress can choose to provide resources to the RTC in increments, but that means having to face the prospect of returning at relatively short intervals as markets changes and, along with them, the estimates.

The RTC faces another important constraint in the form of FIRREA's obligation limitation. This is the provision which limits obligations -- most notably, working capital borrowings -- to the amount of unused REFCORP authority, cash on hand, and 85 percent of the fair market value of assets held by the Corporation.

The RTC is likely to run up against the obligation limit as soon as or even sooner than it reaches $50 billion in losses. If

the RTC cannot raise additional working capital and the cost of acquiring assets exceeds the amount generated from sales, it cannot proceed with resolutions.

The Oversight Board intends to work with the Congress and the Administration to develop an approach which will provide the RTC the resources necessary to finish the job, while maintaining adequate controls. Given the enormous significance of this issue for the federal budget, we believe that this is a matter which should be considered in the current budget discussions between the Administration and the Congressional leadership.

In closing, we would echo a view expressed recently by Chairman Seidman. This is a long, hard job and it will take an extended period of time to finish it. However, we stand behind the commitment made by President Bush in his first weeks in office: protect depositors; clean up the industry at the least cost to the taxpayers; and punish the criminals.

ATTACHMENT 1

Among the requirements established in FIRREA for this appearance, Oversight Board must:

-- "provide an estimate of the short-term and long-term cost to the United States Government of obligations issued or incurred during such period;" and
-- "describe the costs incurred by the Corporation in issuing obligations, managing and selling assets acquired by the Corporation."

As of March 31, the RTC had issued about $2.5 billion in obligations in the form of short-term working capital borrowings from the Federal Financing Bank. No significant costs were incurred in connection with the issuance of these obligations. As required by FIRREA, these borrowings are backed by assets having an estimated fair market value substantially in excess of $2.5 billion, in order to comply with the 85 percent test. Based on current projections of market value, we expect that the U.S. Government ultimately will not incur any cost in connection with these short-term obligations.

At the present time, virtually all of the assets under the RTC's control are managed either by institutions in conservatorship or, with respect to receivership assets, by acquirers pursuant to short-term contracts. Thus, for the reporting period, the costs of managing and selling RTC assets has been borne at the conservatorship and receivership level, and about $30 million was paid to private contractors for this purpose. It should be noted, however, that the RTC's operating plan for the third quarter of fiscal year 1990 contemplates an expenditure of $70 million for payment of fees to asset management contractors, reflecting the anticipated widespread use of asset management agreements.

AFFORDABLE HOUSING SALES FROM 100 Units Demonstration

		PROPERTY TYPE	TIME ON MARKET (Days)	Appraised Value	List Price	Sales Price	Family Size	Buyer's Income	# of Offers	INCOME ELIGIBILITY LIMIT	BUYER'S INCOME As % of ELIGIBILITY	OFFEROR's INCOME < 80%	OFFEROR's INCOME 80%+	FINANCE SOURCE	RTC Repair Cost
EASTERN REGIONAL OFFICE - (ATLANTA)															
1	AL	CONDO	51	$33,000	$34,500							0	0		
2	AL	CONDO	51	$34,000	$37,900							0	0		
3	AL	CONDO	51	$35,500	$37,000							0	0		
4	AL	CONDO	51	$35,500	$37,000							0	0		
5	FL	SF	51	$35,000	$38,000							0	0		
6	FL	SF-2	51	$26,500	$29,150							0	0		
7	FL	SF-4	51	$35,000	$68,200							0	0		
8	FL	CONDO	51	$44,000	$44,000							0	0		
9	SC	CONDO	51	$31,000	$31,000							0	0		
10	SC	CONDO	51	$30,000	$30,000							0	0		
11	SC	CONDO	51	$29,000	$31,900							0	0		
12	SC	CONDO	51	$30,000	$30,000							0	0		
13	SC	CONDO	51	$31,000	$31,000							0	0		
14	PA	SF	51	$35,000	$38,000							0	0		
15	PA	SF	51	$15,000	$16,500							0	0		
16	LA	CONDO	60	$8,800	$8,800							0	0		
17	LA	SF	60	$36,900	$36,900							0	0		
18	LA	SF	60	$23,900	$23,900							0	0		
19	LA	SF	60	$52,800	$52,800							0	0		
20	LA	CONDO	60	$5,500	$5,500							0	0		
21	LA	SF	60	$55,900	$55,900							0	0		
22	LA	CONDO	60	$8,800	$8,800							0	0		
23	LA	SF	60	$29,500	$37,950	$30,000	2	$8,000	1	$30,700	26.06%	1	0		
24	LA	CONDO	60	$8,000	$8,000							0	0		
25	LA	SF-3	60	$33,500	$33,500							0	0		
26	LA	SF	60	$48,900	$48,900							0	0		
27	LA	SF	60	$25,000	$27,500	$26,250	3	$17,727	1	$34,550	51.31%	1	0		
28	LA	SF	60	$50,900	$50,900							0	0		
29	LA	SF	60	$67,100	$67,100	$67,000	2	$17,367	1	$30,700	56.57%	1	0		
30	LA	SF	60	$47,900	$47,900							0	0		
31	LA	SF	60	$30,900	$30,900							0	0		
32	LA	SF-4	60	$42,000	$42,000							0	0		
33	LA	SF	60	$30,500	$37,950	$34,000	3	$11,326	1	$34,550	32.78%	1	0		
34	LA	SF-4	60	$51,900	$51,900							0	0		
35	LA	SF	60	$67,500	$67,500							0	0		
36	LA	SF	60	$49,500	$49,500							0	0		
37	LA	SF	60	$57,900	$57,900							0	0		
38	LA	SF-2	60	$64,900	$64,900							0	0		
39	LA	SF	60	$17,500	$17,500							0	0		
40	LA	SF-4	60	$51,900	$51,900							0	0		
SUBTOTAL\AVERAGE				$36,185	$36,714	$39,313	3		4	$32,625	46.89%	4	0		
TOTAL SALES\ERO - 4															

Attachment 2

AFFORDABLE HOUSING SALES FROM 100 Units Demonstration

SOUTHWEST REGIONAL OFFICE - (DALLAS)

			PROPERTY TYPE	TIME ON MARKET (Days)	Appraised Value	List Price	Sales Price	Family Size	Buyer's Income	# of Offers	INCOME ELIGIBILITY LIMIT	BUYER'S INCOME As % of ELIGIBILITY	OFFEROR's INCOME < 80%	OFFEROR's INCOME 80%+	FINANCE SOURCE	RTC Repair Cost
1																
2		TX	SF	14	$48,500	$48,500	$48,500	1	$28,279	2	$33,000	85.69%	1	1		
3		TX	SF	74	$45,500	$45,500	$45,500	1	$27,450	1	$33,000	83.18%	0	1		$42
4		TX	SF	9	$49,500	$46,000	$46,000	4	$37,000	4	$47,150	78.47%	0	4		$3,21
5		TX	SF	9	$48,500	$48,500	$48,500	2	$16,005	1	$37,700	42.45%	1	0	CONV	$3,21
6		TX	SF	32	$65,400	$66,000	$66,000	5	$31,611	1	$50,900	62.10%	1	0	FNAB	$69
7		TX	SF	74	$59,000	$59,000							0	0		$49
8		TX	SF	43	$57,500	$59,000	$59,000	4	$30,322	1	$47,150	64.31%	1	0	FNAB	$1,62
9		TX	SF	74	$52,000	$57,000							0	0		$42
10		TX	SF	9	$38,000	$39,000	$39,000	2	$23,940	1	$37,700	63.50%	1	0	FNAB	$3,48
11		TX	SF	10	$54,200	$54,200	$54,200	3	$33,290	2	$42,450	78.42%	0	2	FNA	$3,72
12		TX	SF	9	$27,000	$26,500		1	$15,660	3	$33,000	47.45%	1	2	FNA	$3,51
13		TX	SF	15	$12,000	$12,000	$12,000	3	$19,920	3	$42,450	46.93%	2	1	UNAV	$89
14		TX	SF	33	$23,000	$23,000	$23,000	3	$38,467	2	$42,450	90.62%	0	2		$49
15		TX	SF	30	$27,600	$27,600	$27,600	1	$25,946	1	$33,000	78.62%	0	1	FNA	$2,61
16		TX	SF	74	$47,000	$47,000	$47,000						0	0		$1,01
17		TX	SF	9	$55,000	$55,000	$55,000	3	$34,650	2	$42,450	81.63%	0	1		
18		TX	SF	14	$50,000	$50,000	$50,000	2	$17,391	3	$37,700	46.13%	1	2	UNAV	
19		TX	SF	17	$50,000	$50,000	$50,000	1	$30,720	3	$33,000	93.09%	0	3	FNA	
20		TX	SF	74	$39,000	$39,000	$39,000						0	0		$42
21		TX	CONDO	16	$44,000	$44,000	$44,000	1	$25,038	2	$33,000	75.87%	1	1	CONV	$49
22		TX	SF	9	$49,500	$49,500	$49,500	3	$40,064	1	$42,450	94.38%	0	1	CONV	$2,43
23		TX	CONDO	14	$43,000	$43,000	$43,000	1	$26,420	2	$33,000	80.06%	0	2	UNAV	$1,62
24		TX	SF	9	$46,000	$46,000	$46,000	1	$22,073	1	$33,000	66.89%	1	0	CONV	
25		TX	CONDO	9	$44,000	$44,000	$44,000	1	$30,008	1	$33,000	90.93%	0	1	UNAV	$68
26		TX	SF	37	$34,000	$34,000	$34,000	1	$31,950	1	$33,000	96.82%	0	1	FNAB	$71
27		TX	SF	14	$49,300	$49,300	$49,300	3	$40,064	2	$42,450	94.38%	0	2		
28		TX	SF	32	$33,000	$33,000	$33,000	1	$20,000	1	$33,000	60.61%	1	0	FNA	$41
29		TX	SF	9	$44,000	$44,000	$44,000	4	$34,939	4	$47,150	74.10%	1	3	FNAB	$53
30		TX	SF	16	$44,000	$44,000	$44,000	1	$28,687	1	$33,000	86.93%	0	1	CONV	$77
31		TX	SF	74	$47,000	$47,000	$47,000						0	0		$1,01
32		TX	CONDO	9	$30,000	$30,000	$30,000	1	$29,610	2	$33,000	89.73%	1	1	CONV	$2,67
		TX	SF	17	$66,000	$66,000	$66,000	3	$39,690	3	$42,450	93.50%	1	2		
SUBTOTAL\AVERAGE					$44,453	$44,581	$40,128	2	$24,350	51	$38,207	63.73%	16	35		$1,17
TOTAL SALES\SWRO - 27																

AFFORDABLE HOUSING SALES FROM 100 Units Demonstration

		PROPERTY TYPE	TIME ON MARKET (Days)	Appraised Value	List Price	Sales Price	Family Size	Buyer's Income	# of Offers	INCOME ELIGIBILITY LIMIT	BUYER'S INCOME As % of ELIGIBILITY	OFFEROR's INCOME < 80%	OFFEROR's INCOME 80%+	FINANCE SOURCE	RTC Repair Cost
CENTRAL REGIONAL OFFICE - (KANSAS)															
1	AR	SF	67	$15,000	$15,000							0	0		
2	AR	SF	67	$26,300	$26,300							0	0		
3	AR	SF	22	$52,500	$59,850	$52,500	2	$25,000	1	$29,800	83.89%	0	1	FHAB	60
4	AR	SF	67	$22,100	$22,100							0	0		
5	AR	SF	67	$23,600	$23,600							0	0		
6	AR	SF	67	$32,100	$32,000							0	0		
7	NE	SF	59	$21,000	$21,000							0	0		
8	NE	SF	79	$11,500	$11,500							0	0		
9	IA	SF	59	$10,000	$10,000										
10	IA	SF	59	$9,300	$9,300										
11	IA	SF	59	$16,000	$16,000										
12	IA	SF	59	$4,800	$4,800										
13	IA	SF	59	$14,700	$14,700										
14	IA	SF		$7,875	$7,875	$7,250	1	$9,000	1	$24,850	36.22%	1	0	Cash	
15	IA	SF	62	$40,950	$40,950	$39,000	4	$28,000	1	$35,500	78.87%	1	0		
16	KS	SF	67	$21,000	$21,000							0	0		
17	KS	SF	67	$5,775	$5,775							0	0		
18	KS	SF	67	$13,650	$13,650							0	0		
19	KS	SF	67	$15,000	$15,000							0	0		
20	KS	SF	67	$24,150	$24,150							0	0		
SUBTOTAL\AVERAGE				$19,365	$19,728	$32,917	2		3	$30,050	66.33%	2	1		
TOTAL SALES\CRO - 3															
WESTERN REGIONAL OFFICE - (DENVER)															
1	CO	CONDO	59	$32,500	$32,500							0	0		
2	CO	SF	14	$37,000	$37,000	$35,000	2	$30,000	1	$30,350	98.85%	0	1	FHA	
3	CA	SF	59	$65,000	$65,000							0	0		
4	CA	CONDO	59	$20,000	$20,000							0	0		
5	CA	CONDO	21	$38,000	$38,000	$38,000	1	$17,000	1	$35,500	47.89%	1	0	FHA	
6	CA	SF	30	$53,000	$53,000	$51,000	2	$26,925	1	$27,000	99.72%	0	1	FHA	
7	CA	SF	59	$59,000	$59,000							0	0		
8	CA	CONDO	59	$51,000	$51,000							0	0		
SUBTOTAL\AVERAGE				$44,438	$44,438	$41,333	2	$9,241	3	$30,950	73.80%	1	2		
100 NATIONWIDE \ TOTAL SALES - 37				$36,126	$47,667	$39,517	2	$10,904	57	$36,023	70.97%	19	38		

AFFORDABLE HOUSING SALES FROM 100 Units Demonstration

PROPERTY TYPE	TIME ON MARKET (Days)	Appraised Value	List Price	Sales Price	Family Size	Buyer's Income	# of Offers	INCOME ELIGIBILITY LIMIT	BUYER'S INCOME As % of ELIGIBILITY	OFFEROR's INCOME < 80%	OFFEROR's INCOME 80%+	FINANCE SOURCE	RTC Repair Cost

NOTES:
1) SV Region received full market value offers and multiple offers. When multiple offers were received, the system of selection was based on time preference, reflecting date of first offer; in cases of substantially similar offer, preference was also given to the purchasers in the lower income range when purchasers met other qualifying ratios. In instances when an offer fell through a backup offer was presented by the broker for consideration and acceptance.

Chairman ROSTENKOWSKI. Thank you, Mr. Glauber.

Mr. Glauber, I would like you to supply this committee with the administration's estimate of the increase in the debt limit that will be required on a month-by-month basis, and I would like that by the end of the week, if you could submit that to us, and I would like it for the next 12 months on a month-by-month basis.

Mr. GLAUBER. Mr. Chairman?

Chairman ROSTENKOWSKI. Yes.

Mr. GLAUBER. We will, of course, do that.

Let me state now that it will be difficult to give you very accurate estimates, because again, it will turn on the pace of which the RTC spends its money.

[See page 69 for further information.]

Chairman ROSTENKOWSKI. Well, accuracy has been something that we have been avoiding for a long time here, Mr. Glauber.

Mr. Glauber, the Government will run out of money sooner than expected because of unanticipated REFCORP borrowings. Are there any other unstable or unpredictable Federal expenditures of which you are aware that may cause similar borrowing uncertainties in the near future?

Mr. GLAUBER. Mr. Chairman, the major source of uncertainty of which I am aware is the expenditures by the RTC, the size and the pace of which those expenditures will proceed.

Chairman ROSTENKOWSKI. You don't know of any other areas where we might be short funded?

Mr. GLAUBER. Well, Mr. Chairman, I must tell you that the figures that I am best informed of are the RTC figures.

I would, for a definitive answer, defer to OMB.

Chairman ROSTENKOWSKI. Could you explain the reasons why additional financing for the savings and loan bailout is needed so soon after last year's legislation provided $50 billion?

Mr. GLAUBER. Mr. Chairman, in testimony last year, during the period FIRREA was being considered, the Secretary made as clear as he could that we were dealing with estimates of numbers that were very hard to pin down precisely.

He said at that time that a number of factors would influence the actual size of the RTC's cost and burden. Since the time that legislation was passed, certain things have become evident. First, we really did not have a good fix, as we suspected at the time might be the case, on just how bad were some of these institutions that would come under the RTC's responsibility.

It was not until the RTC could get into these institutions, look at the records, appraise the assets, that we could really get a fix on just what would be the losses.

Beyond that, certain economic factors, which are terribly crucial to the costs here, have evolved in a way different from forecast. As you know, and as I suggested in my statement, real estate markets are much softer than anticipated, and real estate is probably the single most important factor influencing both the value of the assets and the loss in these institutions.

Beyond that, interest rates have been higher than we anticipated; and again, that has influenced both the real estate market and the losses in these institutions.

The junk bond market has turned out to be much weaker than we forecasted. So there have been a number of factors that have occurred since then which have influenced losses and the value of these assets and will continue to in the future, and that is the reason that we think the most responsible approach is to present a range of estimates rather than one single number. And that is what we have done.

Chairman ROSTENKOWSKI. Could you estimate any time when you will have a definite fix on what the cost would be?

Mr. GLAUBER. I think unfortunately the answer to that will be not until we are done with the whole process.

Chairman ROSTENKOWSKI. And when do you anticipate that will happen?

Mr. GLAUBER. Clearly, it's going to go over the period that the RTC was created by statute, which is 7 years. It's not going to be until we sell the assets that we take into these—from these savings and loans that we are finally going to know what it costs.

We are committed to spend what it costs, but unfortunately there is no way to know until you have sold the last asset.

Chairman ROSTENKOWSKI. Well, Mr. Glauber, I will tell you, I think it's a darn shame that we are going to lay this responsibility of bailing out these savings and loan associations on our children. I sincerely believe that this committee ought to look very seriously about a definite tax with respect to the bailout.

Now, whether that will be acceptable or not, I don't know. But the idea of prolonging this for 30 years is something that I find very, very unsatisfactory.

Mr. Archer.

Mr. GLAUBER. Mr. Chairman. If I just might make one comment.

The bailout is not of the savings and loans. It really is the bailout of our commitment to the depositors.

Chairman ROSTENKOWSKI. I understand that. I understand that. But somebody wasn't watching the store, Mr. Glauber.

Mr. GLAUBER. I understand that. I think you would agree that this administration moved as quickly as it possibly could to deal with this problem when it came into office, and we are working every day to try and resolve it as quickly as possible.

Chairman ROSTENKOWSKI. Mr. Archer.

Mr. ARCHER. Mr. Chairman, I did not intend to say this, but your comment makes me recognize the fact that in 1986, President Reagan sent up a request for $15 billion to the Congress to help to solve this problem at a time when it could have been rectified at a much lower cost. It was held up by the majority in the Congress, led by the Speaker at that time, and the money was not made available because there were Members of Congress who didn't want their special savings and loans closed down.

In addition, the chairman of the Banking Committee joined by the Speaker, insisted that there be forbearance put in the legislation when it was finally enacted in late 1987. This forbearance meant that the regulators could not shut down the savings and loans and get to the bottom of the problem.

And I think it's grossly unfair to imply that in some way or another, the administration was involved in failing to do this, that they were asleep at the switch, as it were, when the Congress of

the United States, controlled by the majority, did not permit this effort to go forward in 1986 when it would have been much cheaper.

So there is plenty of blame to go around, and I think we ought to focus on how we clean up this mess and move forward, as I said earlier in my comments. And along that line, Mr. Glauber, can you tell this committee what action—and I know this is out of your field, but perhaps you can give us some information—is ongoing to indict those who are guilty of malfeasance in the management of these savings and loans and recover assets that have been hidden away? How long is this going to take? Why isn't it occurring more rapidly, and what we might estimate will come back in the way of restitution to defray some of these costs?

Mr. GLAUBER. Well, Mr. Archer, as you know, President Bush several weeks ago announced a stepup effort to seek out fraud and criminal behavior in the savings and loans, to recover funds that can be recovered.

The Justice Department has formed a special task group. OTS has forwarded to the Justice Department a large number of cases for their pursuit, and this effort now is going to move into an even higher gear than it has before.

It's going to be an effort which will stretch again over a long period of time. These are very complicated cases that cannot be brought to court quickly. And it's difficult for me, and I think even for the people closer to the process than I, to estimate how much will be recovered.

But the administration is committed to recover every nickel that can be recovered and to bring to justice every perpetrator of fraud in these financial institutions.

Mr. ARCHER. Well, what kind of estimate do you have at this point as to what percentage of these losses might be recovered, reasonably be recovered?

Mr. GLAUBER. Mr. Archer, I don't have with me a specific estimate. I would be happy to provide the best number we can for you for the record.

[The following was subsequently received:]

By their very nature, most cases involving fraud in financial institutions are very complex and can take a long time to prosecute. The RTC, OTS and the Justice Department have put together a process that we believe will yield significant results. Unfortunately, it is very difficult to make any estimate of the recoveries that will ultimately result from these efforts. For example, many of the institutions that we expect the OTS to convey to the RTC have not even failed yet; among those cases in which investigations have already begun, many are in the very early stages.

During testimony before Ways and Means on September 19, 1990, Chairman Seidman was asked this same question. Although he suggested that recoveries of 3 to 4 percent would be outstanding, he emphasized that the RTC has no estimate at this time.

Mr. ARCHER. OK. Thank you very much.

Mr. GIBBONS. Mr. Glauber, since you are the messenger, I will give you another message.

When, you know, this administration, the Bush administration, according to the President's own words, it's just a continuation of the administration that began in 1980, and in that time, the debt has grown from less than $1 trillion to over $3 trillion. And in the

last 10 months, you spent all the money you have told us you would spend in 12 months.

And I am convinced you are hooked on borrowing and now you come in here and suggest that we borrow another $700 billion, or almost two-thirds of $1 trillion, just to get you through the next 2 years.

And my response to you is no. Now, I will back off, but I have to see the President come forward with a plan. He is the President of the United States. He has convinced the voters that they don't need to pay for anything. They can just keep on borrowing, and my message to him, sir, is no.

Mr. GLAUBER. Mr. Gibbons, I think the President has come forth quite boldly in bringing to the table the budget negotiators, and it's in that forum that decisions will be made, and I think properly, as to how these funds—how funds will be obtained to pay for these costs.

It's a big burden, a big problem, but I think it appropriately will be determined there. And I think the President has shown great leadership in getting those budget talks moving forward.

Mr. GIBBONS. All I see in this document that you have submitted today as your testimony is another $700 billion worth of borrowing. That is George Bush's proposal to work our way out of the deficit. It's ridiculous.

Mr. Rostenkowski submitted a proposal earlier this year that was much braver than anything I have seen come out of the White House. And, you know, the President is the person that convinced the people that everything was fine, that nothing needed to be done; certainly no new taxes.

Now, I cannot convince them, he's got to go out there and convince them. I have tried to convince them for many, many years that you cannot get along on this borrowing. It won't work.

And until the President is ready to move, there is no way we can do any more than just sit here and chat back and forth.

Mr. GLAUBER. My understanding is that the budget negotiations are moving forward, that they have received a push forward from a number of sides——

Mr. GIBBONS. These are fine people in the budget negotiations. That is the greatest minuet that has happened since—well, in the lifetime of any of us in this room; let's put it that way.

Chairman ROSTENKOWSKI. Mr. Pickle.

Mr. PICKLE. Thank you, Mr. Chairman.

Mr. Glauber, I have three or four questions to ask you.

One, you said the RTC has $4 billion in junk bonds in its portfolio. Can you tell me the date of the purchase of those bonds?

Mr. GLAUBER. No, I cannot. We would have to go back to the records of the institutions that bought them originally.

Mr. PICKLE. I would like to have that for the record.

Second, you said that you are limited on a—net amount of funds you can borrow because of the specific limitations to the amount of the unused REFCORP authority cash on hand and 80 percent of the fair market value of assets held by the RTC.

Are you recommending that that 85 percent be raised?

Mr. GLAUBER. I am making no specific recommendation. What I will say is this, that the form of the note cap which currently exists

will almost certainly have to be modified when new money is made available, because the note cap envisions funds available from REFCORP.

New funds will come from the Treasury and the form of the note cap will have to be altered.

Mr. PICKLE. What I am trying to find out is, you mentioned that in here as a problem for you, and I assume by mentioning it, you are recommending that that limitation be raised from 85 to what, 100 percent?

Mr. GLAUBER. I am not specifically making that recommendation. What I wanted to point out is that because of the functioning of the note cap, RTC will likely have to slow down its resolutions at a time when it will still have on the order of $12 billion of loss funds available to pay for losses.

Mr. PICKLE. Well, then, you are not recommending, you are just observing that that is a problem.

Mr. GLAUBER. I am observing that it's a fact and suggesting that as we move forward, it's something we ought to consider.

Mr. PICKLE. I merely want the record to show that you are not recommending, but you are just pointing out that it's a problem.

All right. Now, you said that you estimate the working capital needs would be from $30 to $40 billion.

Mr. GLAUBER. Excuse me, Mr. Pickle. I think I said $20 to $40 billion.

Mr. PICKLE. $20 to $40 billion. That is correct.

My question to you, is this $20 to $40 billion in working capital, is it in addition to the $26 billion in working capital that has already been raised?

Mr. GLAUBER. Yes, that would be. That would be for the next fiscal year. We have raised roughly $26 billion——

Mr. PICKLE. In addition to the $26 billion?

Mr. GLAUBER. I might add, Mr. Pickle, there will be additional funds raised through the Federal Financing Bank in the final fiscal quarter of 1990.

The other is for fiscal year 1991, sir.

Mr. PICKLE. Now you have said that with respect to additional financing that there is precedent in the Federal budget for providing indefinite authority to fund activities.

Are you asking for unlimited authority to borrow funds?

Mr. GLAUBER. As I said in my statement, we can imagine several different approaches that Congress could take; it could authorize funds for one or several years, or it could provide an indefinite authority. That decision I think obviously is the decision of Congress.

What I did suggest was that there is some precedent in cases like this where there is a commitment, where the fund—where the expenditure is not discretionary, to provide an indefinite——

Mr. PICKLE. Mr. Secretary, I am a bit concerned. On the one hand you say this limitation of the 85 percent of assets is a problem, but you don't recommend changing it. Now you are saying that the precedent for unlimited borrowing. You are recommending unlimited borrowing, are you not?

Mr. GLAUBER. I said that that is one approach Congress could choose to take. If Congress chooses to take a different one, we will

be up here a number of times talking about additional funds needed——

Mr. PICKLE. You are just saying that is another problem. But as I read the testimony in both instances, you raised those points and you are recommending it, and now you are waffling on it. It disturbs me, so I would like to have a clear position if you can state it, or provide it for the record.

Mr. GLAUBER. Mr. Pickle, I think——

Mr. PICKLE. What is the administration recommending?

Mr. GLAUBER. The administration believes that those issues should be discussed in the forum of the budget negotiations where other related matters can be considered at the same time, and that is its recommendation.

Mr. PICKLE. Let me ask you something on a more timely basis. Yesterday REFCORP issued about $5 billion in bonds, which carried an average interest rate of 8.93 percent in interest.

Mr. GLAUBER. That is correct.

Mr. PICKLE. Comparable Treasury bonds sold at the same time, were sold at 8.55-percent interest rate. Now, that is a 0.38-percent spread, clearly, going in one direction as against another direction.

Can you tell me the additional cost to the taxpayer that results from borrowing $5 billion with a 0.38 basis point spread?

Mr. GLAUBER. Our calculation, Mr. Pickle, makes that number slightly less. The fact is, as we discussed a year ago before this committee, we believe that the structure of REFCORP made a great deal of sense, and ultimately will have saved the taxpayer money as compared to other proposals before Congress.

Mr. PICKLE. Well, Mr. Secretary, my question is, what is the additional cost to the taxpayers initially in this 0.38-percent spread?

Mr. GLAUBER. The only way to answer that is to ask what would have happened if we had chosen to fund this money, $30 billion, through REFCORP by a different mechanism.

Mr. PICKLE. Mr. Chairman, I will ask the staff to try to give us an estimate of that figure, because there has got to be a figure, the best guess you made 2 years ago. We ought to have some kind of figure in hand and not just say that it is conditional.

You tell me why this kind of an increase in interest is continuing between Federal borrowing and the other?

Mr. GLAUBER. Mr. Pickle, REFCORP bonds have been sold at a premium over Treasury bonds of roughly, an average of 29 basis points for the four issues that we have issued. We believe now, as we believed a year ago, that the REFCORP structure was a more effective structure and in the long run will save the taxpayer money.

Mr. PICKLE. You are going to save the taxpayer money and yet you are giving an additional 0.38 spread. Now, my question is, should Congress consider discontinuing the issuance of this kind of debt?

Mr. GLAUBER. Mr. Pickle, again, I think that the REFCORP structure, for the reasons that we went through last year, made a great deal more sense than driving a hole in the structure of the Gramm-Rudman-Hollings targets at that time.

In the future, as I said in my statement, since money will come from the Treasury and cannot come from the home loan bank system, the argument for REFCORP is much, much weaker.

Mr. PICKLE. Have we reached a point where we should borrow this on Treasury notes on budget?

Mr. GLAUBER. I think for the future moneys that are appropriated, since they will come from Treasury, they should obviously be borrowed through Treasury.

Mr. PICKLE. Mr. Chairman, my time has expired.

Thank you, Mr. Secretary.

Mr. FRENZEL. Secretary Glauber, we are glad to have you here today. We hope that at some later date you will be glad you have been here, but that probably will not occur very soon.

There has been a lot of talk here about why we need to borrow more money. You or the administration has been accused of not making a deficit reduction offer. I seem to remember that the President put a budget on the table in January. I also seem to remember that the Congress has not been able to pass its budget, and while the Congress screams for more offers from the President it hasn't been able to put one single, solitary offer on the table.

Yes, the Senate has passed one; yes, the House has passed one, but they haven't even gone into conference, apparently incapable of making an arrangement. And I think most of us recall that when the House passes its conference report on the budget, it automatically passes a variation of the debt ceiling resolution over to the Senate. So the House would have done its job on that which you request if the Congress had been able to give us a budget.

Quite clearly, I think the responsibility lies with the Congress, and to my other friends who are complaining about the amounts of money that they need to be borrowed, I didn't notice you joining with me to vote against the appropriations that spent the money. We were tight. I congratulate you for whatever contribution.

We have been talking about the budget summit being a dance, and if it is, then Mrs. Frenzel will understand why I have been unsuccessful in achieving anything at the budget summit, or maybe while all Congressmen are not able to achieve something there.

But the problem here with that debt ceiling resolution is, every year that those of us who have danced, however inexpertly, that we do not want to pay the piper. The money is spent; the problems have accumulated, whether it was my regulation or your regulation, or your bad law, or my bad law, but the obligations are there. The only way they are going to be covered is by borrowing.

I think it is well to ask questions of the administration on how it intends to get through this situation, what its intentions are for the future, how it intends to handle the S&L problem. But, I am nervous that we are unseemly, if we explain so much about somebody else, when in fact we have been awfully busy spending the money ourselves.

I hope that this little monolog has given you a little breathing room in your——

Mr. DORGAN. Would the gentleman yield?

Mr. FRENZEL. I do yield to the distinguished gentleman from North Dakota.

Mr. DORGAN. The gentleman is in the Budget Committee, and I wonder if you would tell me based on your judgment if the Congress has spent any significantly different amount than the administration has recommended over the last decade?

My impression has been that while the administration has recommended substantially higher defense spending, Congress has appropriated higher domestic spending. But on balance, there has not been a plug nickel's worth of difference in spending appetite on behalf of the administration or the Congress. And if that is the case——

Mr. FRENZEL. That is an interesting myth, I will tell the gentleman, and I will be glad to present him with some of those figures.

In general, it is true that the administration has wanted to spend more in military, and sometimes in foreign aid, than Congress has been willing to, and Congress has wanted to spend more on entitlements and other domestic spending. I think the key, however, is the amount of the deficit included in the budget of the Presidents. At least since I have been on this campus, and in the flying share of the cases, the ultimate deficit achieved by Congress in its appropriating and entitling has far exceeded the deficits proposed by the Presidents during that period.

Mr. Chairman, I yield the balance of my time.

Chairman ROSTENKOWSKI. Mr. Downey?

Mr. DOWNEY. Mr. Chairman, there was a wonderful book, I think maybe you have read it, Mr. Glauber, by Robert Fulghum, "Everything I Wanted to Know I Learned in Kindergarten." One of his great lessons is to clean up your own mess, which I think is an appropriate departure point for us, considering this problem.

You said that last year REFCORP off-budget made sense, but this year, direct borrowing from the Treasury is a better way. I missed the transitional explanation for why it didn't make sense last year, but makes sense this year to be on budget.

Mr. GLAUBER. Let me try and explain that, Mr. Downey. A purpose of REFCORP last year was to make certain that the industry paid its fair share, and REFCORP captured the contribution of the industry and made certain that it would be paid.

We have now exhausted the amount that we believe the industry can reasonably pay. Future funding, we believe, will have to come from the Treasury. Since it will come from the Treasury, Treasury borrowing of course makes sense. It is a very different situation this year from last.

Mr. DOWNEY. Right. Well, you know, the accuracy of your predictions would make the Hubble telescope look good, frankly, and one of the points that you made in your statement is that you didn't know, or the Treasury didn't know how bad the savings and loans were last year.

Do you know how bad they are this year?

Mr. GLAUBER. We are learning better every day, Mr. Downey.

Let me point out that last year we were only one of a number of agencies making predictions of the cost of the cleanup, including GAO, the FDIC. Our estimates were in line with theirs. All of us have been made wrong by the evolution of events.

Nobody predicted the way the real estate market would evolve, interest rates would evolve, or indeed just how bad some of these

savings and loans were. Until we were on the scene, the RTC was on the scene, it was impossible to know this.

Mr. DOWNEY. Yes. Well, of course, staff informs me that the GAO said that in February of 1989, that at least $85 billion or more would be needed.

Did you take that estimate into account when you told the Congress that what was needed was $50 billion?

Mr. GLAUBER. I believe the GAO at that time, and I don't have before me the particular document, was talking about the cost that included both the RTC's burden and also the burden of what had been done previously.

Mr. DOWNEY. Yes.

Mr. GLAUBER. We are talking at this point about the $50 billion burden of the cost to the RTC.

Mr. DOWNEY. Alone.

Now, let me ask you how the request for $4 trillion in borrowing by fiscal year 1993 fits with the balanced budget effort that the administration is putting forward. Do you feel a twinge of hypocrisy coming up here asking for $4 trillion in borrowing, at the same time asking the Congress to pass a constitutional amendment to balance the budget?

Mr. GLAUBER. No.

Mr. DOWNEY. No. Why not?

Mr. GLAUBER. Mr. Downey, first of all, we are engaged in negotiations now at the budget summit for how to seek deficit reduction. We all are committed to doing that. I know you are. You know the President is. So those negotiations lie in the background for all of this.

Beyond that, I point out that some of this deficit increase is simply there—or excuse me, debt limit increase is simply there to accommodate the investment by the various trust funds, the largest of which is the Social Security trust fund.

Mr. DOWNEY. I am not sure I got an answer. It is all right to borrow money now, but it is not all right to borrow money in the future?

Mr. GLAUBER. How we will pay for the expenditure programs that are going to be undertaken is the subject of negotiations of the budget summit, Mr. Downey, in which everybody is involved.

Mr. DOWNEY. Well, let me ask you, do you think we can balance the budget any time soon with the fact that you have told us you can only ask a range for the amount of money that will be needed to bail out the savings and loan as one example?

Mr. GLAUBER. Mr. Downey, I believe Director Darman testified yesterday on the balanced budget amendment. Furthermore, as you know, the administration is seeking a variety of reforms to the budget process, which will help keep the deficit under control.

Mr. DOWNEY. This is what is known as the tiniest of fig leaves.

Let me ask one question that appeared in a local newspaper in my congressional district called Newsday, where they suggest that when you take a look at where the money is going in the savings and loan bailouts, that predominantly depositors in the Southwestern portion of the United States will be the principal, if they can be called this, beneficiaries, and the people paying the bill will be in the Northeast.

And a Professor Hill from Cleveland estimates that New Yorkers, for instance, will be paying $12.6 billion in net revenue outflow to solve this problem, and that Texans will be receiving a $49 billion transfer from all parts of the United States.

How do I explain that to the people on Long Island? What would you say to them if they saw this in the paper that this is going to be a massive transfer of wealth from the parts of the country that have not speculated to those parts of the country that have?

Mr. GLAUBER. I think, I wouldn't pretend to tell you what to say, but in that situation I think I would point out to these people that all Americans benefit from the deposit guarantee of the Government, and that at some time in the future, banks and thrifts which do not now see themselves in trouble could be in trouble, and those depositors will benefit.

Mr. DOWNEY. That is a good political answer.

Mr. GLAUBER. Thank you.

Mr. DOWNEY. Wait for the recession that might hit us, so that some of the Texas can turn around and bail us out.

One of the geniuses of this political system, if you go back to the Treasury, and we have to go explain this stuff to our constituents. That is not an answer, Mr. Glauber.

My time has expired.

Chairman ROSTENKOWSKI. Mr. Pease.

Mr. PEASE. Thank you very much, Mr. Chairman.

Mr. Glauber, I would just like to reinforce what Mr. Downey just said. Cleveland State University is quite near my home district in Ohio. Professor Hill from that institution has projected just recently that Ohioans will pay $670 per person for this bailout and that Texas will gain $4,775 per person, and that money will be transferred from 37 States, like Ohio, to only 13 States.

Now, recently we passed in the House and Senate a Clean Air Act which will impact very heavily on Ohio and Indiana and Pennsylvania and Illinois because of the cost of cleaning up the air, particularly related to acid rain.

We saw the cost-sharing arrangement to get the folks from Texas and California and other States to help that national problem, I think clean air is good for the whole country. We were turned down flat.

Now, why is it, I ask you again, that Ohioans should instruct me, their elected representative, to support a bailout which costs us a bundle of money when we have relatively few insolvent thrifts, and send the money down to another section of the country, when we in Ohio have been told certainly you have created your own problems, don't come to us.

Mr. GLAUBER. Mr. Pease, the beneficiaries in Texas and indeed all over the country are depositors. I don't see that we have much choice. We made a commitment to these depositors and I can't imagine that we could tell every third depositor, "I'm sorry, your money is not good." We made that commitment. We have to make good on it.

The system benefits all Americans, and I think in the long run it is an appropriate system. So I just don't see how we can do anything except what we are doing. We have to make good on these deposit commitments, and those are the people being bailed out.

Mr. PEASE. Mr. Glauber and Mr. Chairman, I would just like to emphasize for members of the committee and for the audience and anybody who may be watching this hearing today, that some of the figures that Mr. Glauber gave in his testimony are truly astonishing figures and were not in my view emphasized as much as they should have been.

What the administration is asking Congress to do is to increase the borrowing of this Nation, this Government, by $417 billion over the next 1 year and 3 months, is that correct, Mr. Glauber?

Mr. GLAUBER. No. I believe it is $386 billion, and if I may point out a couple of things about that number. Some fraction of that amount is going to pay for working capital for the RTC, which is permanently spent—excuse me, temporary funds needed to buy assets which will be later sold. A large part of that money is to allow for the investment of the Social Security and other trust funds, so there are a number of things in that number.

Mr. PEASE. Mr. Glauber, speaking of Social Security trust funds, during the last—recently in the 1980s when we had a problem with the debt ceiling, the previous administration disinvested Social Security trust funds in order to get by. We were told later on that the Reagan administration would not do that again.

What is the position of the Bush administration about failing to invest Social Security trust funds, or disinvesting Social Security trust funds in the event that we come up to a crunch?

Mr. GLAUBER. We have said we would only disinvest the Social Security trust fund to make Social Security payments. And that is the statement by which we stand.

We believe that given our forecasts, it will be possible fully to invest the normalized tax transfer to the Social Security trust fund at the beginning of August of this year.

I point out, Mr. Pease, that if it is necessary not to invest part of the normalized tax transfer, under most circumstances, that does not lead to a loss of interest by the Social Security trust fund.

Mr. PEASE. Under most circumstances, but under some.

Let me just finish reciting these figures which I think ought to be emphasized. You said in your statement that you are seeking a debt limit through fiscal year 1991 of $3,509 billion. I think the American people would understand it a little better if we said $3.509 trillion, and you are proposing in your testimony today to raise the borrowing of the Federal Government by almost $1,961 billion over the next 3 years, is that correct, Mr. Glauber?

Mr. GLAUBER. That is based upon current projections by OMB of deficits, which takes into account changes in funding that the administration has proposed for the budget summit.

Mr. PEASE. We are talking, Mr. Glauber, at least the summiteers seem to be talking about being able to reduce the deficit by $55 billion perhaps. They are afraid to do more than that by way of spending cuts and tax increases for fear of plunging the economy into a recession. $55 billion as against a $417 billion increase in borrowing, still leaves an enormous amount of borrowing.

How are we going to come up with the interest payments on an additional $400 billion of borrowing?

Mr. GLAUBER. The issues you raise, Mr. Pease, are good issues and I believe they are the issues that are engaging the budget summiteers 2 and 3 days a week for much of the day.

Mr. DORGAN. Would the gentleman yield?

Mr. PEASE. If I have time, I would be happy to.

Mr. DORGAN. I wonder if you gentlemen might tell us in the year 1993, with a debt of $4 trillion, what would the annual interest cost be in the budget?

Mr. GLAUBER. I don't have it in front of me. I will be happy to ask the staff that are here to get it, if possible, or supply it for the record.

[The following was subsequently received:]

According to the Mid-Session Review of the Budget dated July 16, 1990, net interest is estimated to total $157 billion in fiscal year 1993.

Mr. PEASE. If I could reclaim my time, just by rough calculations at today's interest rates, that would be in the neighborhood of $300 billion, interest alone.

Thank you, Mr. Chairman.

Mr. GLAUBER. Mr. Dorgan, the detailed number will be available in the Mid-Session Review, I believe.

Chairman ROSTENKOWSKI. Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman.

Welcome, Mr. Secretary.

Mr. GLAUBER. Thank you.

Mr. MCGRATH. I think what you are hearing from my fellow members on the committee is the frustration that we all are encountering when it comes to this seemingly unseemly situation that is occurring with our savings and loans and the fact that there seems to be no end to this thing.

I look back to the votes last year on keeping this on budget, and having the Treasury issue the notes and thinking that was a good vote, and then voting against the entire package last year and thinking now that that was a pretty good vote, and I share the frustration.

Mr. MCGRATH. I would caution that it often assumes that all of the money in the savings and loans in Texas came from Texas. And I would point out that many of the brokered deposits, those $100,000 brokered deposits came from other areas of the country. As you have pointed out, it may or may not have been wise to raise the insured amount from $40,000 to $100,000—and in my judgment it was not. It precipitated this kind of a scheme where there are people in our area, and different areas of the country who do have brokered accounts and deposits in Texas banks.

Could you tell me, Mr. Secretary, what the cost of the budget function for interest on the national debt was in 1980 as opposed to what it is today?

Mr. GLAUBER. Just 1 minute. I think we can probably get you that. Back in 1980, the net interest on the public debt was about $52 billion.

Mr. MCGRATH. And what it is today?

Mr. GLAUBER. In fiscal year 1990 we estimated it at $175 billion.

Mr. MCGRATH. It's an incredible increase over the last 10 years for a function of the budget that doesn't buy an airplane, doesn't

provide a Meal on Wheels, doesn't provide any kind of service that the Government seemingly is in business to provide.

Let me if I might add to where I think the chairman was going with his question, or his request that you give a month-by-month account of how much the Treasury actually is going to need to satisfy its borrowing, and let me ask you this.

Wouldn't it be more prudent to ask for a short-term extension of the debt limit, and then when we have a budget summit resolved at a later date, perhaps in October, November, or December, and you would come to us at that time with a more realistic assessment of what we need? Wouldn't that be more of a prudent way of handling this at this point in time?

Mr. GLAUBER. Well, Mr. McGrath, we want a budget deal as an outcome of the budget summit, by the end of this month, and if there is an outcome, we think that the debt limit and a permanent debt limit increase, could be included as part of that.

Mr. MCGRATH. I agree that you will probably have an agreement from the summiteers, maybe by the end of this month, or perhaps before we leave in August, but then I don't think this is going to be accomplished by both Houses of the Congress before sometime, perhaps even after the election.

And my question to you is, given the reality of the situation, wouldn't it be more prudent to go for a smaller, shorter term debt ceiling increase at the present time to cover us through that period of time, and then come back later on when we have a budget summit agreement in place, and then go from there?

Mr. GLAUBER. Mr. McGrath, the reality may dictate that. The reason we asked for a permanent increase is that we have found by our experience at Treasury that when we come up against either a permanent or a temporary debt limit the steps we often have to take can have the effect of raising the cost of financing the Government's operations. We would like not to confront that more often than is necessary.

Mr. MCGRATH. I thank the chairman for his indulgence.

Chairman ROSTENKOWSKI. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

Mr. Glauber, I want to follow up on what Mr. Pease was saying. For the next 12 months, beginning October 1 through 1991 October, you are going to be asking for $387 billion, and then October 1991 through October of 1992, you are going to ask for another $332 billion, making a total, if I am not mistaken, of $719 billion, is that correct?

Mr. GLAUBER. I believe those calculations are correct.

Mr. MATSUI. I would like to underscore that by raising some past debt increases that the Congress approved with the assistance of the administration.

Back on February 7, 1981, after President Reagan had been in office less than 1 month, a little over 1 month, at that time the national debt was $985 billion, and we increased it through September 30, 1991, to $1.079 trillion, which was an increase of less than $100 billion, about an $80 billion increase, and I recall many of my colleagues on the other side of the aisle, and on the Floor of the House, voted against that, because they said that was Jimmy Carter's debt, and they weren't going to be responsible for it.

Now you are asking us essentially over the next 24 months to increase that debt by some $700 billion, at the same time asking for a balanced budget constitutional amendment. Is that my understanding today?

Mr. GLAUBER. Yes, sir.

Mr. MATSUI. Now, the constitutional amendment that is on the floor of the House that will be taken up next week mandates a balanced budget by 1993. It is my understanding that the outer limits of this budget summit that you seem to hold as a crutch, the most that they are going to get over 5 years is $650 billion, is that correct?

Mr. GLAUBER. Those are numbers that have, I have read in the press.

Mr. MATSUI. You don't think we are going to get a trillion dollars, do you, out of it, over the next 5 years? I mean, no one is talking about that, is that correct?

Mr. GLAUBER. I have not heard that number.

Mr. MATSUI. So realistically, the outer limit is $650 billion?

Mr. GLAUBER. Okay. If you say so.

Mr. MATSUI. I am not saying so. I am reading about it in the Washington Post and New York Times, I am assuming that your office has some knowledge about this issue.

Mr. GLAUBER. My office has not been a party to the budget summit.

Mr. MATSUI. I hope you are reading the same newspapers that everybody else is reading.

Mr. GLAUBER. I am.

Mr. MATSUI. Do you expect then by 1993 you will be able to propose a balanced budget, your administration?

Mr. GLAUBER. Mr. Matsui, I think that is going to turn on the outcome of congressional votes, on the balanced budget——

Mr. MATSUI. Wait a minute now. The best we can do is $650 billion. The President hasn't even agreed to that number yet, isn't that correct, $650 billion? You are asking for $719 billion over the next 2 years. We are talking about $650 over 5 years. Now you are going to balance the Federal budget in 1993?

Mr. GLAUBER. Mr. Matsui, to take as an example the increase in the debt limit for 1991, which you calculated at $387——

Mr. MATSUI. I am using your numbers, these are your numbers, are they not?

Mr. GLAUBER. They are indeed our numbers, and the calculation as best I can see is absolutely correct.

The point I wanted to make to you, sir, is that the deficit is only a portion of that number. A fraction of that is also for working capital to be used by the RTC, which working capital will return to the Treasury.

Mr. MATSUI. Thirty billion dollars next year, right?

Mr. GLAUBER. A fraction of that is——

Mr. MATSUI. OK. So let's knock off $30 billion, so that makes it $357 billion, right?

Mr. GLAUBER. Another $30 billion would be knocked off, simply because it is needed for a peak in debt subject to limit at the beginning of September; a large fraction of that is money—is debt limit

capacity in order to invest the Social Security trust funds. The deficit is just a——

Mr. MATSUI. What number is that? How much is that?

Mr. GLAUBER. The surplus estimated in the Social Security trust fund for fiscal year 1991 is about $75 billion.

Mr. MATSUI. Right. So you are talking about over $200 billion actual deficit, right?

Mr. GLAUBER. I believe that the numbers that have been in the press for the actual deficit are around $160 billion.

Mr. MATSUI. Well, you are asking for a little over $200 billion, if you subtract the $70 and subtract the $30, you are basically at $287. Am I mistaken, or are you mistaken?

Mr. GLAUBER. I believe that in those numbers is about $176 billion for the deficit, including outlays for savings and loan resolutions .

Mr. MATSUI. Well, the savings and loan will be an obligation of the Federal Government, right?

Mr. GLAUBER. Absolutely.

Mr. MATSUI. Well, then, why not put it in? I want to know if you really honestly believe, and I know you are not under oath, but honestly believe that we are going to balance the Federal budget if we pass this constitutional amendment by 1993, because you are supporting that.

Your administration, your President is supporting that. I want to know if you really honestly believe you are going to be able to come up with such a budget.

Mr. GLAUBER. Let's pass the balanced budget first.

Mr. MATSUI. Wait a minute. We did that in 1981. Now we have a trillion dollars of obligations that we are talking about, so let's think about it a little bit more than we did.

You want to pass it and then tell me we are going to come in with a balanced budget.

Mr. GLAUBER. I think the first step would be to pass it.

Mr. MATSUI. That is really incredible. I am really astonished that you would ask us to pass it and then not know whether or not you are going to come up with a balanced budget by 1993, even though if we mandate it under the Constitution of the United States? That is absolutely amazing.

Mr. GLAUBER. If it were mandated, that would be the mandate.

Mr. Matsui, these negotiations which are going on as we both know in the budget summit are going to determine this, and I think that is the appropriate place for them to go on.

Mr. MATSUI. I will tell you, my frustration isn't over the savings and loan issue, my frustration is over the hypocrisy of this administration.

Chairman ROSTENKOWSKI. Ms. Kennelly.

Mrs. KENNELLY. Thank you, Mr. Chairman.

I really am afraid, Mr. Chairman, that what we are hearing this morning is a preview of elections to come in the fall. I have a feeling that the public is going to become bored and quite annoyed, because I would just like to quote something that a person who is coming before us later in the day has to say about the savings and loan crisis.

It is the joint political responsibility of several administrations and Congresses. It is the result of thoughtless deregulation, irresponsible Federal insurance, inept oversight. It is also the result of a level of thrift corruption, greed and stupidity on the part of owners, managers, real estate owners and junk bond peddlers.

I think we should clean up the problem and let's not look back at what is behind us. We are all too aware of the problem.

I would ask to continue something that Mr. Matsui raised Mr. Glauber. You say that you are not involved with the summit, and I realize that. But you are here today in place of our Secretary of the Treasury, Mr. Brady.

Mr. GLAUBER. Who is in Houston at the summit, as you know.

Mrs. KENNELLY. Which I realize, but you must have conversations in the Treasury Department. You are in charge of our finances. The man I just quoted was Mr. Rohatyn, who we are going to hear from later on in the day.

Has there been any talk in Treasury about the fact that we have a $130 billion problem, and we keep borrowing and making it go into a $500 billion problem. Is there any talk about solving this as Mr. Rohatyn has suggested, in the next couple of years by doing something dramatic, pay as we go rather than borrow?

Mr. GLAUBER. Well, as I am sure you know, it is very unusual for us to talk about associating particular revenue sources with particular programs in the budget. We typically finance the entire budget and make a decision of what kinds of revenue sources will be available for it. So it is unusual indeed to talk about matching, as Mr. Rohatyn has done. I think he talks about a tax surcharge, to pay for this particular part of the Federal spending. We just simply don't do that normally, funding is fungible, and we just don't do that.

I will add that some people have suggested that this particular expenditure, which does not in any sense make demands on future goods and services, but simply makes good on a commitment we already have made, probably has less of a call on increased tax revenues than some other expenditures might.

Mrs. KENNELLY. Well, I might——

Mr. GLAUBER. It is again most unusual for us to talk about funding part of a budget one way and part of a budget another way. Money is fungible.

Mrs. KENNELLY. Well, I might suggest that I think we should look at some bold and innovative answers before we just decide to borrow from future generations.

Let me ask you about something else. We understand there is a new policy at the RTC that they let savings and loans be sold before they become controlled by the Government, because they are worth more.

Can you tell us this morning if this new policy is going to result in a dramatic change in numbers that we are probably going to have to pay up?

Mr. GLAUBER. I think it is impossible to say. As has been reported there is under discussion a pilot program of accelerated resolution.

This is typically what is done with banks by the FDIC. They try to arrange for sales of banks before they are actually put into con-

servatorship. This program is now going to be done on an experimental basis in the hope that it will save the taxpayer money.

Mrs. KENNELLY. But it is a new policy. This is a new policy compared to what was presented to us before?

Mr. GLAUBER. This is an attempt to save the taxpayer money by doing what is in fact done with banks all the time. That is to try and arrange—whether it is franchise value in the bank or thrift for a sale—a merger before the institution is actually put into conservatorship. It would only be done if it could save the taxpayer money.

Mrs. KENNELLY. Aren't we finding though that when the RTC takes over a savings and loan, the lapse of time results in greater loses, and that is why this new policy has been suggested?

Mr. GLAUBER. The conservatorship process is destructive of value, particularly in cases where there is franchise value. Because once an institution is in conservatorship, the name associated with a conservatorship process and franchise value deteriorates.

This accelerated resolution program will be used only for those institutions that have franchise value.

Mrs. KENNELLY. I am not being critical. I am glad to see some new ideas coming forth.

Quickly, Mr. Chairman, one last question.

On page 8 of your testimony, you say,

> Moreover, it must be emphasized that this is not a discretionary activity. The Government's deposit guarantee must be fulfilled. There is a precedent in the Federal budget for providing indefinite authority to fund mandatory activities. In addition, Congress will have plenty of oversight.

Mr. Glauber, aren't you suggesting in those words a new entitlement? Are you asking for open-ended funding?

Mr. GLAUBER. We are not asking for a new entitlement. We made a commitment to depositors when we insured their deposits up to $100,000. We now are engaged in a program to make good on that commitment to depositors. It will cost whatever it costs to do. We are committed to make that cost as low as possible.

What is suggested is, one way to deal with that commitment, which is a mandatory expenditure, is to have an indefinite appropriation.

Mrs. KENNELLY. I am sympathetic. But when I look at the summit and they are talking about cutting entitlements for example, Medicare, something we committed to the elderly of this country, I just wonder how we can put this kind of testimony in front of this committee and think it is possible.

Mr. GLAUBER. Well, Mrs. Kennelly, we could, I am sure, say to every third depositor, "I'm sorry, your money is not good," but I am sure you would agree with me, that is something we ought not to do.

Mrs. KENNELLY. Well, from my first statement, I think there is an awful lot more we have to think about than the depositors, those junk bond salesmen and a few others. But my time is up.

Thank you, Mr. Chairman.

[Subsequent questions to Under Secretary Glauber and his responses follow:]

ANSWERS TO REPRESENTATIVE KENNELLY'S QUESTIONS

Question 1. Can you tell me whether this hiring freeze is still in effect, and what we are doing to assure that interested buyers at least can find someone to talk to about purchasing these assets?

Answer. We are not aware of any hiring freeze at the RTC. Indeed, it is our understanding that the RTC has made every effort to staff up as quickly as is prudently possible. For example, the RTC's projected staffing level for September 30, 1990 is 6,688 people, up from the current level of about 5,700; the RTC is adding about 150 people each pay period.

With regard to potential buyers of assets, the RTC has made significant efforts to put in place an easily accessible process for the sale of assets. Such efforts include the creation of about 15 regional sales centers, which serve as retail "storefronts" for the RTC's assets. The RTC has also created toll-free numbers for interested buyers to get information on properties, and has arranged for many State and local housing agencies (as well as non-profit housing organizations) to act as information clearinghouses for the RTC's affordable housing properties.

Question 2. Is the RTC taking advantage of innovations in the financial markets such as securitization in order to maximize the overall costs of the bailout?

Answer. Yes. The RTC has hired a financial advisor, Greenwich Capital Markets, for advice regarding the securitization of single family mortgages. The RTC has also hired legal counsel to prepare documents for securitization, and is currently analyzing loan portfolios of several institutions with the objective of initiating a pilot program involving the issuance of mortgage-backed securities.

Question 3. What does the administration consider a resolution, the sale of deposits, or an end of the drain to the Federal treasury?

Answer. The typical RTC resolution of a failed thrift involves putting the institution into receivership and selling it to an acquirer. Because of the volume of poor quality assets in many of these thrifts, most acquirers are interested in purchasing only the deposits and good assets. Thus, after these institutions are resolved by the RTC, the RTC is left with substantial amounts of the poor quality assets to sell.

Of course, both the administration and the RTC recognize that the resolution process will not be completed until all institutions are resolved and all assets are sold. Indeed, it is impossible to know with any degree of certainty what the ultimate cost to the RTC will be until all assets are sold. In recognition of the importance of selling assets, the RTC has recently unveiled "Operation Cleanup," which should accelerate the RTC's efforts in this area.

Question 4. What additional costs are we going to incur to finance the deficit given the drop in foreign buyers of U.S. Government debt? And do you perceive a drop off in foreign buyers given rising German and Japanese interest rates?

Answer. The actual budget deficit for June 1990 totaled $11.2 billion. In the Mid-Session Review of the budget released July 16, 1990, OMB estimated that the fiscal year 1990 deficit will be $220.1 billion, compared with the $123.8 billion estimated in January.

Net interest paid to the public increased from $175.6 billion in the January estimate to $181.4 billion in the Mid-Session Review, reflecting a larger deficit and higher interest rates than estimated in January, when OMB assumed interest rates would decline in the first half of fiscal year 1990. Our most recent data show that foreign holdings of Treasury securities have decreased only slightly this fiscal year, through April (latest available). We do not believe that foreign ownership activity has had a measurable impact on interest rates this fiscal year to date.

Mr. CARDIN. Thank you, Mr. Chairman.

Mr. Glauber, I understand that under current projections you believe we will hit the $4 trillion debt level by fiscal year 1993, absent any change from the summit. How can that be done if we comply with the Gramm-Rudman law?

Mr. GLAUBER. Excuse me. How could that be done if——

Mr. CARDIN. If we comply with the Gramm-Rudman targets, that could not be.

Mr. GLAUBER. That is correct.

Mr. CARDIN. So you are assuming that the Gramm-Rudman law would be changed if you were going to need a debt ceiling of $4 trillion by fiscal year 1993?

Mr. GLAUBER. I think our numbers are based on OMB numbers in the Mid-Session Review, which is based on a set of Government policies.

Mr. CARDIN. A. d assumes that Gramm-Rudman would not be——

Mr. GLAUBER. Those deficit numbers exceed the Gramm-Rudman targets.

Mr. CARDIN. If I understand, one of the explanations at least for using REFCORP debt versus Treasury debt was that we wouldn't put, I believe using your words, a hole in Gramm-Rudman last year?

Mr. GLAUBER. Yes.

Mr. CARDIN. And in reality, we are going to put many holes in Gramm-Rudman this year.

Mr. GLAUBER. What we do about Gramm-Rudman, I think, is again the subject of negotiation. It was our view last year that were we to put the expenditure of funds for the savings and loan program on budget, and then exempt it from Gramm-Rudman, we would at that time destroy the process.

Furthermore, we believe that REFCORP was an important way to capture and assure that the funds from the industry would be used——

Mr. CARDIN. I understand your second point, but stick to the first point. In hindsight, would you not agree that it would have been better in regard to the Gramm-Rudman argument to use Treasury debt rather than exempting it from Gramm-Rudman, considering the extra basis points that we are paying?

Mr. GLAUBER. I believe there were other arguments which still are quite persuasive for using the REFCORP structure. I believe it was the appropriate structure to use.

As I pointed out to Mr. Pickle earlier, now that we are going to move forward and regrettably have to use Government funds for funding the rest of these losses, a different structure obviously makes sense.

Mr. CARDIN. There are a lot of different terms that are used here, and I think the public is rightfully confused on how the savings and loan crisis is being funded. We have FIRREA, we have the REFCORP debt, we have working capital—on budget, off budget, advanced funding—and it gets very confusing.

I would like to, if I could, to center on your most recent projection, which, as I understand it, using current dollars, the loss to the taxpayers will be between $90 and $130 billion?

Mr. GLAUBER. Our estimate for the cost to REFCORP over the next years for the institutions that would come under its control, in present value terms, would be $90 to $130 billion.

Mr. CARDIN. That is going to mean that at certain times you are going to be advancing funds in order to take care of failing savings and loans, you will be using working capital, a lot of different bookkeeping aspects to it, so the cash is going to go in and out, but the bottom line is, it is between $90 and $130 billion.

Mr. GLAUBER. If we had to write a check today, we are saying that.

Mr. CARDIN. In response to Mr. Archer's question, you were unable to give us the figures on recoveries. it seems to me that you

have to be doing some projections if you are getting between $90 and $130 billion, some projections as to how that plays out year by year, how much will be advanced, how much will be recovered, which assets will be sold, when they will be sold, and I am wondering if you could share that with this committee, if we could get some estimate from you as to how you project, or how you arrived at that $90 to $130 billion?

Mr. GLAUBER. We will be happy to share with this committee, with its staff, the broad methodology that we have used in making these estimates.

They are based on, as you can imagine, quite complicated models of cash flow, which try to take account of the uncertainties involved.

Mr. CARDIN. I come from a State that went through a savings and loan problem, so I understand some of the difficulties that you have, but we were able to give projections on how much cash we would need at different times. We also put in projections on recoveries.

What range are we working under on recoveries? There are insurance companies that should be held responsible. There are individual assets. It has been a year now.

Have we come to any model as to what type of recoveries we expect to be able to get from individuals or insurance carriers?

Mr. GLAUBER. Mr. Cardin, one of the major uncertainties is the amount that will be recovered; or said the other way, the amount of losses that will be experienced on these assets. And that is why a number ranges, in fact that is the primary reason why, the number ranges from $90 to $130 billion.

Mr. CARDIN. Have you looked at what Maryland did on recoveries and try to use that as some projection?

Mr. GLAUBER. Our past experiences, more importantly I think for this experience, we have now begun to gather concrete data on the RTC's own experience, and what I can tell you is that the experience the RTC has had falls within the range of assumptions we have made on the fraction of losses that will be experienced.

So we believe that the $90 to $130 billion encompasses what will ultimately be the number.

Mr. CARDIN. But the material that you will make available to our staff will reflect the assumption that you are making on recoveries of insurance companies and from individuals?

Mr. GLAUBER. It will, it will reflect the assumptions we are making, in particular in the form I think easiest to understand in aggregate on the fraction recovered, because clearly, it is built up of a number of different recovery experiences, and really the best we can do is make an aggregate assumption of what fraction of losses will be experienced on these assets. We can compare that for you and for your staff with what the RTC has experienced so far, which I think is the best benchmark we have.

[The following was subsequently received:]

The administration's estimates for the RTC's present value cost of resolving the institutions that will become its responsibility are $89 billion to $132 billion. These numbers depend upon the number of thrifts and the RTC's loss experience. They are based on the estimate that the RTC will have to resolve between about 700 to just over 1,000 thrifts. The lower number reflects the number of thrifts the RTC had

resolved and those in conservatorship, plus those thrifts assigned by the OTS to group IV in May.

The OTS considers Group IV institutions as likely to be transferred to the RTC. For the higher number of thrifts, those thrifts assigned by the OTS to group III were added; the OTS considers these thrifts troubled due to poor earnings and low capital, but is uncertain as to whether they will require RTC's attention. If the number of thrifts in groups III and IV changes substantially, then these estimates will change as well.

The negative net worth of these institutions was one of the primary measures for estimating costs, as well as losses on the sale of assets, expenses associated with managing receivership assets, and continued operating losses.

The losses on the first 52 resolutions through early April, 1990 (when we were preparing these estimates for the Secretary's May 23, 1990 testimony before the Senate Banking Committee, and June 14 testimony before the House Banking Committee) were the RTC's reported losses based upon onsite reviews. Since the May and June testimonies we have updated our estimates to reflect the RTC's resolutions through June, 1990. This update did not substantially change our present value estimates.

The total assets of institutions not yet resolved were divided into 14 asset types: cash, government and agency securities, mortgage-backed securities, high yield bonds, other investment securities, derivatives, performing permanent mortgages on 1-4 family residences, other performing mortgage loans, consumer loans, all other loans, other real estate (ORE), other delinquent assets, services subs, and other assets. Each asset type was given a different mark-to-market estimated loss percentage, or "haircut," for three different scenarios (low, medium and high). The RTC experience so far has been within these haircut ranges.

For those institutions in conservatorship as of July 1, 1990, the weighted average haircuts for the institutions' aggregated total assets—which depend on the particular mix of assets in the group—were 14.5, 17.1 and 23.2 percent, depending upon the scenario. For the 700 thrift estimate, the weighted average haircuts (which are different because of a different mix of asset types) were 13.7, 16.3 and 22.5 percent. The weighted average haircuts for the 1,000 thrift estimate were 12.4, 15.5 and 20.8 percent. The haircuts for the medium scenario were based upon the FDIC's Division of Research bank failure cost model (which provides the most reliable data available on loss experience), and the low and high scenarios assumed the situation changed for the better or worse.

A certain percentage of each of the 14 asset types was assumed to pass to an acquirer, depending upon the type of resolution (whole bank, clean bank, or liquidation/deposit transfer); these assumptions were consistent with the RTC's current experience. Each asset type (of the assets not passed) was assumed to have a different pace of sale, which was made to be consistent with the RTC's goals for the sale of assets.

The RTC's pace of resolution was based upon the total assets of the institutions resolved each quarter, and was not based upon the number of institutions resolved. The pace of resolution used for most the administration's estimates was $40 billion of assets per quarter. This is consistent with the RTC's current pace of resolution.

It was assumed that the institutions to be resolved would not grow before being put into RTC conservatorship, at which point some downsizing of some of the better assets would occur. This has in fact been the practice up to now. Operating losses were assumed to continue before and during conservatorship until institutions were resolved by the RTC.

Different interest rates and other economic factors, including changing real estate markets, will clearly have an effect on the number of institutions that will fail, as well as the losses experienced by the RTC in resolving these institutions. Because these factors are impossible to accurately predict, the administration's estimates were for ranges of both the number of institutions and the losses on those institutions' assets.

An 8.35 percent discount rate was used for the present value estimates. This was the rate charged by the Federal Financing Bank in April, 1990, when cost estimates for the RTC were prepared for Secretary Brady's testimony before the Senate Banking Committee on May 23, 1990.

Mr. CARDIN. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Sundquist.

Mr. SUNDQUIST. Thank you, Mr. Chairman.

I want to commend the gentlelady from Connecticut on her statement. I think it serves us all well to be reminded there is enough blame to go around and we ought to try to figure out what the solution is. I also don't think it is productive for us to question one region's receipts of payments versus another region of the country on isolated issues.

I can say with some certainty that the people of Tennessee and the people of Texas who were unable to deduct sales tax expenses are subsidizing the people of New York who have a sizable deduction from their State income tax and city taxes.

Have we been able to determine what percentage of the cost of the S&L crisis has come as a result of the junk bond failures?

Mr. GLAUBER. We have not made that specific estimate. As I said in my statement, the RTC owns roughly $4 billion worth of junk bonds and has the prospect of receiving some more. There was at one time about $12 to $14 billion worth of junk bonds held in S&Ls, and a large fraction of the S&Ls holding junk bonds will eventually become the responsibility of the RTC.

Mr. SUNDQUIST. Far be it from me to say that most of those came from New York City, but I wouldn't say that.

Mr. Secretary, the cost of increasing the Government deposit guarantees from $40,000 to $100,000, that occurred in, I think, 1978 or 1979.

Mr. GLAUBER. 1980.

Mr. SUNDQUIST. 1980. That cost, do you have any numbers on what that is costing in terms of the whole crisis, the S&L crisis, that increase from $40,000 to $100,000?

Mr. GLAUBER. We don't have any specific estimates, but it is certainly clear that a number of nearly insolvent S&Ls were able to finance themselves with, as was suggested earlier, brokered deposits, right under that $100,000 limit. As you know, FIRREA directed the Treasury to engage in a study of deposit insurance, and we will be looking at, among other things, the $100,000 limit as part of that study.

Mr. SUNDQUIST. When will that be completed?

Mr. GLAUBER. The law directs us to complete it by February of next year. We have said that we would like to complete it by the end of this year.

Mr. SUNDQUIST. And as part of that study, will you make recommendations potentially on reducing that guarantee?

Mr. GLAUBER. We will certainly consider that, among other alternatives.

Mr. SUNDQUIST. And so you have no numbers right now as to what percentage of the total cost came as a result of that action in 1980?

Mr. GLAUBER. I don't and I must say I think it would be difficult to obtain a good estimate of how much the $100,000 limit contributed. It would be a very hard number to estimate. But we are looking very carefully at what should be done about the $100,000 limit.

Mr. SUNDQUIST. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Mr. GIBBONS [presiding]. Mr. Levin.

Mr. LEVIN. Mr. Secretary, one of the keys to resolving the budget crisis is for the public to understand what it is, and the nature of

it. So let me just try to boil it down. What you are suggesting is an increase in the debt ceiling from $3.1 trillion to over $4 trillion in 3 years? Is that not correct?

Mr. GLAUBER. Over 3 years, yes. Again, subject to current projections by OMB of the deficit, which projections clearly could change, depending on the outcomes of the budget summit.

Mr. LEVIN. All right. But still, let's try to put this in terms that the public can understand. That is about a 30 percent increase in 3 years.

Mr. GLAUBER. Yes.

Mr. LEVIN. Now——

Mr. GLAUBER. Mr. Levin, again, let me emphasize that there are discussions in the budget summit for substantial deficit reductions, and both sides are making great efforts in pursuing those. Any changes from OMB's assumptions would clearly change the amount of funds needed—the amount of debt limit needed.

Mr. LEVIN. All right. But still, you are proposing this increase that is 30 percent. What is the most reasonable optimistic increase in GNP that could occur during those 3 years. And let me also ask you this. If we follow the pattern of the last 3 years, during the next 3 years—the GNP, during those next 3 years, would increase by that, 10 or 11 percent?

Mr. GLAUBER. If we can get back to a path of 3 percent per year growth, that would be a reasonable number.

Mr. LEVIN. All right. So what is being suggested here is an increase in the national debt that would be 20 percent greater than the growth in GNP?

Mr. GLAUBER. Mr. Levin, again, I think all of us are committed to deficit reduction.

Mr. LEVIN. I know. But you are coming here and asking us for a 3-year increase.

Mr. GLAUBER. Predicated on the numbers available in the Mid-Session Review for deficit projection, which are based again on assumptions about deficit reduction in the summit, and——

Mr. LEVIN. I assumed that. Look, we are trying to tell the public what this is all about.

Mr. GLAUBER. Well, Mr. Levin, in that connection, we also, all of us are saying to the public, we are committed to deficit reduction to the extent we are successful in these negotiations, and achieve meaningful deficit reduction, these numbers may be reduced.

Mr. LEVIN. Well, but the proposal—let me just go on, because I think you are trying to somewhat undercut the impact of these figures, and I think the public needs to understand them.

Now let me just ask you this. Have you seen the chart distributed by the chairman of the committee on the growth of the national debt as a percentage of GNP?

Mr. GLAUBER. No.

Mr. LEVIN. Let me just, if I might, hand this to you.

Mr. GLAUBER. Thank you.

Mr. LEVIN. You see on attachment 3 that this projection, I think it is a projection for 1989, is that the debt is 55.6 percent of GNP. Do you know what the figure is for—the likely figure for 1990?

Mr. GLAUBER. Our projection for the debt for fiscal year 1990 is $3,163 billion. I would have to do some calculation to get a percent-

age of the GNP. But Mr. Levin, what I had pointed out is just on this page. If you look at the deficit as a percentage of GNP, it has been falling steadily since the mid-1980s.

Mr. LEVIN. The percentage of GNP in 1980 was 34 percent of the debt.

Mr. GLAUBER. Excuse me. I was talking about the deficit. That is the second column of the sheet you handed me.

Mr. LEVIN. The percentage of GNP represented by the national debt was 34 percent in 1980, 55.6 percent in 1989, and if you project a 10 percent increase in GNP over these 3 years, and a 30 percent increase in the national debt, that means that the percentage of GNP represented by the national debt has to go over 60 percent by 1993, isn't that true?

Mr. GLAUBER. But Mr. Levin, the point I was trying to make is I don't think any of us are projecting an increase in the debt of that amount.

Mr. LEVIN. So why are you asking for this?

Mr. GLAUBER. I am asking for something that is based on the Mid-Session Review.

Mr. LEVIN. I just want the public to understand that what you are suggesting today means that the percentage of GNP represented by national debt would have gone up from 34 percent in 1980 to about 60 percent in 1993.

Mr. GLAUBER. Mr. Levin, I would read what we covered in my statement as simply focusing the attention of all of us, the public and all of us here, on the need for meaningful deficit reduction, and I think we are all committed to do that. It is important that we accomplish it.

Mr. LEVIN. Well, I think it would be useful for you to submit for the record your calculations of the percentage of GNP represented by the national debt under your proposal, and under various scenarios of deficit reduction.

Mr. GLAUBER. Mr. Levin——

Mr. LEVIN. The public should understand what dramatic shift has occurred in the 1980s, and the heavy burden that we are shifting now to the next generation, no matter what happens in the next few months, and I am in favor of something dramatic happening. There has been a dramatic shift here.

Thank you.

Mr. GIBBONS. Haven't you somebody there who gets paid to make a proposal? With all of those employees, a hundred and some thousand people you have in your Department, it would seem one of the clerks could put together a proposal.

Mr. Flippo.

Mr. FLIPPO. Thank you, Mr. Chairman.

Mr. Glauber, I attended a hearing with Secretary Regan in 1982, and I was just looking back over it. At that time Mr. Anthony here asked Secretary Regan, who was before the committee to ask for an increase, he asked him if he would be back in front of Congress asking for an additional increase in the debt ceiling in view of the fact that Mr. Anthony felt that his economic recovery program was unjustified, and Secretary Regan said at that time, no, he would not.

But he did state that if in the event he did come back and ask for an extension, that he would acknowledge that it was due to the present administration's policies, I think is the way he phrased it at that time.

We hear an awful lot of talk about the great recovery that the Nation has experienced in the last decade, and I wonder if you would agree that it would be fair for those who want to claim credit for the great economic recovery to also take the blame for the $2 trillion increase in debt that the American taxpayers had to incur.

Mr. GLAUBER. I think that the sources of that increase in debt are many. It is to a considerable extent decisions about programs and the levels at which we would spend money on them. I think that it is a complicated negotiation process.

Mr. FLIPPO. It is the results of the Nation's revenue and expenditure policies, is it not?

Mr. GLAUBER. I would agree with that.

Mr. FLIPPO. You know, for 35 years after World War II, up until 1980, the Nation's deficit, with rare exceptions, was between 1 and 2 percent of its gross national product. But beginning in 1980, every year of that decade the deficit exceeded 2 percent, going up to 6 percent, to the extent that now we have gone from $1 to $3 trillion in debt, and the debt service has gone from $53 to $175 billion.

It seems to me that there is probably not a proper sense of urgency in the country today to deal with that, even though 2.9 is much better than 6, but it is not as good as 0.5 and the averages that went through there for a long time. Do you think in your view that there is a proper sense of urgency to deal with that deficit in the administration today and the Congress and in the country?

Mr. GLAUBER. Well, I appreciate the comments you are making, and I think it is first important to point out that the deficit as a percentage of the GNP has been declining, and that is important.

Mr. FLIPPO. If you would permit me, yes, it has been declining, but it did not—it has not declined during the decade. In other words, it started out at the beginning of the decade. It is higher now than what it was at the beginning of the decade. Would you agree with that?

Mr. GLAUBER. In 1989 it was one-tenth of 1 percent higher than it was in 1980.

Mr. FLIPPO. So when you say it has been declining, you have to be rather selective about the period that you are describing it is declining, would you not?

Mr. DORGAN. Would you yield?

Mr. FLIPPO. Yes.

Mr. DORGAN. Would 2.9 include the Social Security surplus funds to make it look better, and without the Social Security surplus, wouldn't it have been much higher than 2.9?

Mr. GLAUBER. It would have been higher.

Mr. FLIPPO. Mr. Glauber, I guess the point I want to make is that I feel a greater sense of urgency to deal with this deficit problem, and I think it is a critical, critical thing, and Mr. McGrath made an outstanding point that this increase of $122 billion in debt service doesn't buy us anything.

Mr. GLAUBER. Mr. Flippo, I certainly agree with you; and Secretary Brady, on numerous occasions, has said that deficit reduction and getting control of the deficit is the number one priority of his Treasury. He is, as you know, deeply committed to trying to make American industry competitive, to getting the cost of capital for American industry down, and the first and most important step we can take in that is to get the deficit under control.

Mr. FLIPPO. And do you believe, then, is the present administration changing the revenue and expenditure policy recommendations of the last decade, or is it generally a continuation of those policies?

Mr. GLAUBER. I believe that the budget we submitted in the beginning of this year is indeed a commitment towards getting that deficit down. We are now working, as are you, I know, hard in these negotiations, to get meaningful deficit reduction. It is the most important thing we can do.

Mr. FLIPPO. It just seems to me that if there are those who want to claim a great deal of credit for the glorious past decade of economic recovery as they would define it, should also remember to include the tripling, or the addition of $2 trillion in debt over that same period of time.

Thank you, Mr. Glauber.

Mr. GLAUBER. Yes, sir.

Chairman ROSTENKOWSKI. Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Chairman.

Mr. Glauber, I am very deeply concerned about the fact that at the summit, we seem to be losing a lot of our economic clout globally and that our fiscal picture has gotten out of control. I would like to just sort of go through a litany of what I see is happening, and there are very dangerous waters ahead.

The Northeast already has pockets of recession. Industrial expansion has been retarded; real estate is very much in the doldrums right now. There are giant State tax increases in the various States in the Northeast. New Jersey has just passed the greatest tax increase ever in its history, $2.8 billion, or if you pro rate that nationally, it is equivalent to us raising $150 billion nationally.

New York State has a large tax that just passed, and Massachusetts has passed the largest tax increase in its history.

Mr. GLAUBER. I know that very well. I am from Massachusetts.

Mr. GUARINI. All right. So we have a tremendous amount of State taxes that are being passed against the people, and there isn't a governor in the Northeast that is not in trouble.

Now, we have a coming Federal tax increase, which the President says that he recognizes should, and must, happen. Plus the fact that we have in the Northeast a shift of wealth to the South or to Texas, where 40 percent of the money, as I understand it, from the whole savings and loan bailout is going to go, which is over $3,500 per person, when New Jersey is losing over $1,000 per capita paying for that bailout.

And very cavalierly you say and dismiss it as well, it is not important as what the impact on the Northeast is; it is just part of our S&L insurance program which benefits our entire Nation. What I am concerned about is that we have a State and Federal tax increase on top of a recession that is in progress, which can

deepen our recession. And you know, when we have this shift of wealth, it is going to create a further impact on trying to lift the Northeast out of a recession.

Now, $59 billion being shifted to Texas, according to the Hill report; a lot of money, that is costing $3.9 billion to my State. Texas is the big beneficiary of all of this, and I am just wondering, have you run numbers as to what the impact of a recession would be on these kind of debt numbers that you are giving us now?

Mr. GLAUBER. I don't believe we run numbers which look at regional impact, if that is what you are talking about. There is no question, as you suggest, that some parts of the economy, some regional economies are weaker than others. I would hesitate to characterize what we are facing as a recession at this point.

Mr. GUARINI. You don't think that these kind of impacts of high State taxes, high local taxes, high real estate taxes in the localities and high Federal taxes, which are being passed across the board, is going to deepen the economic plight of our country today?

This doesn't fit into your equation at all? You haven't even thought it was important to run numbers in case we don't have the GNP growth?

Mr. GLAUBER. Excuse me. I thought you had asked had we run numbers of the impact of the S&L expenditures on various——

Mr. GUARINI. I am asking whether or not you have run numbers concerning the impact that this S&L impact will have on our country if we are in a recession?

Mr. GLAUBER. Well, again, I would say that it is the view——

Mr. PICKLE. Will the gentleman yield?

Mr. GUARINI. Yes. I yield to the gentleman from Texas.

Mr. PICKLE. I notice that the gentleman keeps insisting this S&L problem is caused by Texas, and there seems no doubt that the Southwest, Texas, Oklahoma, Louisiana, New Mexico, has been harder hit, or at least that problem has surfaced quicker than in other parts of the country. I keep noticing, though, that in recent months the same problem that is existing now in California, perhaps as much as Texas. In Florida, a couple of weeks ago. I noticed that Massachusetts was protesting. The same problem that was created in California.

Is this a national problem, or is it just strictly a regional problem?

Mr. GLAUBER. Well, there is no question that the possibility of weak banks can occur throughout the Nation; some have occurred, in fact, in my home State of Massachusetts.

Mr. GUARINI. Well, if I can reclaim my time, I think it should be well pointed out that 40 percent of the money is being shifted to Texas, and that Texas is the beneficiary.

Here you have corruption, waste, fraud, abuse, criminality, influence peddling, high standards of living, affluent lifestyles and incompetence in one state that is now deepening the economic plight of the Northeast, and I am wondering whether or not the Treasury Department has any kind of a parity in mind where we can get some kind of noncyclical funds or some way to help the Northeast in case there is a need for housing and education and health care delivery and other social programs.

Because if we don't, we are going to see a tax revolt in our country, and we are going to see it in the Northeast, and that is what the Treasury is going to be facing.

And I see no concern about what could be out there, because all we are doing is taking the rosy scenario all the time.

Mr. GLAUBER. If I may disagree with you. The Treasury is very sensitive to regional problems in credit availability. We have been carefully following allegations of credit crunch, particularly in real estate and particularly in the Northeast. We have taken steps to deal with that. We have assembled the regulators to make sure that regulatory standards are properly and even-handedly applied.

Mr. GUARINI. That is in regulations that were lax at one time, but I am talking about noncyclical funds, to try to get some kind of fairness into our system. Because we can't go on paying for the problems of another part of the country if we don't have the money to pay for it. Could I ask you whether or not the Federal Government has run the kind of figures that Mr. Hill has run so that we know how much money is being transferred from the Northeast to other parts of the country?

Mr. GLAUBER. I would like, if I might, to look in more detail at Mr. Hill's numbers before I give you a response. I will be happy to give you a response for the record.

Mr. GUARINI. Would you please give a response, and would you please run your numbers, so that we would know exactly what your figures are as to what the cost is per capita in the other States of our country?

Mr. GLAUBER. I will be more than happy to look at his and comment on those.

[The information follows:]

The type of analysis presented by Professor Hill is problematic, subject to rebuttal and probably counterproductive in setting in print an ill-advised and faulty scorecard of losers and winners. Hill's analysis presents a distorted view of both the causes and aftermath of the S&L crisis and diverts attention from the important issues. A much more productive approach would be to analyze the effect of Federal deposit insurance, and related regulations, on the behavior of savers and investors. This type of analysis would, in turn, facilitate the design of a fair and efficient deposit insurance system.

Mr. PICKLE. Mr. Chairman, may I ask the gentleman's time be extended for 1 minute?

Chairman ROSTENKOWSKI. Mr. Dorgan will have to do that, and I am sure that he won't.

Mr. PICKLE. Will you yield for 1 minute?

Mr. DORGAN. Mr. Pickle, I intend to take all my time. You can ask Mr. Chairman for an extension, but otherwise I intend to take my 5 minutes.

Mr. Glauber, you have a tough job, and I understand that, but I want you to understand why you have met some skepticism here this morning. It is not just political skepticism.

We hear all the time, those of us in public life and in politics, that the Bush administration officials trumpet the success of the economy as a Bush/Reagan administration success, and then point to the deficit as a congressional failure. Many of us get kind of tired of that. We have heard from a lot of people sitting in your seat over the last years that I have served on this committee, and a

lot of them have just peddled a bunch of economic fairy tales to us. They knew it wasn't true.

Projected interest rates of 4 percent and unemployment rates almost at zero, that were just pure economic fairy tales, and they did it with straight faces.

And the message has always been the same. Now, part of the message this morning from a member of the minority side was to say again, well, Congress spends all this money. The Appropriations Committee has demonstrated to us that we have spent slightly less than the administration has asked for in 9 years. Not much difference in how much we want to spend. The difference is in whether we want to pay for it or not. We have a dollar's worth of Government to pay 80 cents in taxes and charge 20 cents to the kids.

Now, the folks back home think that is nuts, and I think it is nuts. I don't intend to vote to increase the debt ceiling, by the way. I have voted for it in the past in some occasions. I don't intend to. I don't agree with this fiscal policy—I think it is crazy, irresponsible, and a charade. If somebody says to you read my lips, no new borrowing, what is your response? At some point, we've got to shut this down.

You are saying today that you want $300 billion more for fiscal year 1991, $300 billion more for fiscal year 1992, $200 billion plus for 1993. Let me read to you the President's message last year when he stood in front of Congress with the State of the Union. He says, "here is my budget; $1.2 trillion is a lot of money," and it is. So he is proposing about $1.2 trillion. He says, this will—"7 years worth of Federal deficit, 6 percent of the gross national product; in this budget I set up, the deficit will be down to 1 percent of the gross national product."

That is not correct, of course, and then he says it means the Gramm-Rudman targets, it brings the deficit down further and balances the budget by 1993 with no new taxes.

I am telling you that when we get to the point of a $4 trillion debt and have to pay $300 billion interest charges every year, there is something fundamentally wrong with the philosophy that takes us in that direction.

So I am just saying that I don't support this fiscal policy. I haven't for a long time, and don't intend to support your request today until and unless this administration bellies up to the table and says look, here's what we want to spend money for, and by God, we are willing to tax people in order to get the money to pay for it, and we are going to stop charging it to the kids.

Is the administration ready to say that?

Mr. GLAUBER. Mr. Dorgan, this administration is committed to deficit reduction. The President has said everything is on the table to achieve that. The numbers in my statement assume savings as an outcome of the budget summit.

To the extent we are successful, the administration, Congress, the negotiators are successful in accomplishing deficit reduction, the need for a debt limit increase may be less; and we hope that that will be the case.

We want a successful outcome of those negotiations.

Mr. DORGAN. But Mr. Glauber, the administration is committed to "read my lips, no new taxes;" that is the commitment. It isn't read my lips, no new deficits, and only 15 or 18 months after the President stands up and gives the State of the Union saying we are going to balance the budget by 1993, you are asking us for a debt ceiling of $4 trillion.

There is something completely out of whack here.

Mr. GLAUBER. We hope to be able to modify that request on the basis of an outcome of the budget summit. Indeed, we think that if we are successful in reaching an outcome of the budget summit by the end of this month, that it would be possible to include a revised debt limit increase as part of that, and that number may be less than what we have requested.

Mr. DORGAN. Let me ask you another question. Is it not the case that today we are taking in taxes from a dedicated source, that is payroll taxes, FICA taxes, for the purpose of putting in the Social Security fund to save for after the turn of the century, and then using that in Gramm-Rudman to show a reduced Federal deficit?

Is that the case today?

Mr. GLAUBER. As you know, Mr. Dorgan, the administration in a January budget proposal proposed a way of dealing with Social Security and dealing with the Social Security surplus.

Mr. DORGAN. I am asking the question, is it true that today we take money from paychecks, call it Social Security, tell people it's going to be saved and use it in Gramm-Rudman to show a reduced Federal deficit?

Mr. GLAUBER. By including it in the Federal deficit, it's lower than if it would be if it were not included.

Mr. DORGAN. To what extent would that be occurring now, probably $74 billion?

Mr. GLAUBER. The surplus estimated for next year, I believe, is $75 billion.

Mr. DORGAN. So without misusing dedicated funds, the Federal deficit would be much, much more than you now project; is that the case?

Mr. GLAUBER. I don't know quite what you mean by misusing, because we take those funds, and we invest them in Government securities.

I cannot imagine investing them in anything safer or indeed in anything else, so I am not sure what you mean by misusing.

Mr. DORGAN. Either you are saving it or you are not. Either you saved it for the future or you have used it to displace other spending accounts or other tax increases to show the deficit that you are reporting to the American people. Which have you done?

Mr. GLAUBER. The size of the deficit, however measured, is too big. We believe it should be smaller.

Mr. DORGAN. But it's about $75 billion bigger than you now report?

Mr. GLAUBER. In those calculations, it would be, that is correct.

Mr. DORGAN. And how quickly would the administration support recommending that? Would you support, for example, next year not misusing Social Security funds if those of us in Congress believe that is a problem, would get something enacted that forces the Social Security funds to in fact be saved?

Mr. GLAUBER. As you know, in January we submitted a proposal which would require payments into a sinking fund to offset, in the case of next year, the $75 billion, although we would phase it in over a number of years.

There are other proposals on the table. We believe that those should be discussed in the budget summit.

Mr. DORGAN. That is sort of like I will stop drinking tomorrow. I mean, I come from a farm background. We like weaning calves. You are saying well, let's do it over the longer term here.

I am saying that if you have a $75 billion collection of Social Security money that we tell the American people that is going to be saved for them and is used as an offset for other spending cuts or taxes that you should be raising, then there is something fundamentally wrong with that.

And we ought to stop it; not next year, not 10 years from now, stop it now and put us back on track and tell the American people what the real deficit is and our steps to try to take care of that deficit.

Chairman ROSTENKOWSKI. Mr. Moody.

Mr. MOODY. Thank you, Mr. Chairman.

Earlier you discussed with several Members the interest cost. In 1980, the interest cost of the national debt was $52 billion. You stated a decade later it's now $175 billion.

Mr. GLAUBER. Yes. Those are indeed, I believe, the numbers I gave you.

Mr. MOODY. We have more than tripled the interest payments. Apparently interest rates have gone up.

Do you believe that the debt is pushing up interest rates?

Mr. GLAUBER. The fact is when the deficit was going up, Mr. Moody, as you know, interest rates by and large were going down.

Mr. MOODY. Not real interest rates. You are too smart to play that game about nominal interest rates.

Mr. GLAUBER. Mr. Moody, I would agree with you that to get real interest rates down——

Mr. MOODY. I am sorry.

Mr. GLAUBER. I would agree, to get real interest rates down, we need meaningful reductions. We believe in the statement that we have made on a number of occasions, I believe it's very important to do that.

Mr. MOODY. Thank you. I think it's very important to put this issue on the record. There are certain Senators who are still saying that deficits don't influence interest rates, I am glad to hear that that is not the administration's point of view.

Mr. GLAUBER. The single most important thing we can do to get the cost of capital for American corporations down is to get meaningful deficit——

Mr. MOODY. We must reduce the cost of carrying the debt. Let's not forget the individual taxpayer as well as corporate America.

Mr. GLAUBER. Of course.

Mr. MOODY. What is the estimated debt loan cost of interest in 1991?

Mr. GLAUBER. By our estimates, which are based on the only thing that we could use to base it, which is the projection of deficits in the fiscal 1991 budget, interest would actually go down in 1991.

Mr. MOODY. Let's assume $50 billion deficit reduction pact is enacted. What is your estimate for interest?

Mr. GLAUBER. I don't have that, but I will be happy to get you that for the record.

Mr. MOODY. Thank you.

You are asking for $386 billion more for 1991, $302 for 1992, and $242 more for 1993. Those numbers assume no progress at the summit?

Mr. GLAUBER. Those numbers are from the Mid-Session Review to be published next week. To the extent that the summit is successful in providing meaningful deficit reduction, the need for a debt limit increase may be reduced.

Mr. MOODY. Thank you.

I am interested to see that you think those numbers will drop. What is going to bring it down?

Mr. GLAUBER. I think the best way of answering that is to get the details from the Mid-Session Review that will be available next Monday.

To be perfectly frank with you, I have not read the Mid-Session Review. I only have available the debt numbers.

Mr. MOODY. I would like to know what it is.

Mr. GLAUBER. We will get the Mid-Session Review on Monday.

Mr. MOODY. There is another big drop in 1992. Following up on Mr. Dorgan's point, it seems as though the President's message to the Congress and to the people only 18 months ago was wildly optimistic.

It isn't just the cost for RTC that has gone up. The whole picture is very different. We are now looking for debt increases that make those statements a mockery. How can we increase the debt, balance the budget, and not ask for taxes.

Would you agree that taxes have to be a part of the package?

Mr. GLAUBER. I believe that what the President has said that everything needs to be on the table.

Mr. MOODY. What ends up on the table?

Mr. GLAUBER. I think the decision of how to get meaningful deficit reduction, Mr. Moody, has to be a process of negotiation among the people who are in fact at the table in the budget summit, and I don't think this is the forum in which to prejudge the way that they will deal with that problem.

Mr. MOODY. No, but I think the President owes it to the American taxpayers to say what his position is, in public. This is a democracy, we want to know if the President is leading or being dragged reluctantly.

Mr. GLAUBER. I believe to read the papers is to see that the President is leading. He made a statement, which has caused something of a political fire storm, but clearly was a, in my view, a statement of boldness, to push the negotiation process forward.

Mr. MOODY. Well, I have seen at least three different interpretations of what increased revenues mean, and some people are saying it only means revenues from growth based on other stimulants.

You do not hold that view?

Mr. GLAUBER. I think the meaning of that will be determined by the process of negotiation, Mr. Moody.

Mr. MOODY. I see. I just cannot get you on record for taxes.

I think all of us realize that there is no way you can achieve any meaningful deficit cut without significant tax rate increases.

Does your department have any views on if there are taxes, what the mix should be between income taxes and other taxes?

Mr. GLAUBER. To say what I think is understood, those are very complex negotiations which are best conducted as a package, with all the pieces on the table and available for discussion.

Nobody would be well served by talking about one piece in isolation. I think we are going to have to have that whole process play itself out and produce a package and hopefully produce a package soon.

Mr. MOODY. All right.

My last point back to interest rate costs. Even if we were to cut the deficit to zero tomorrow, we would have to pay $175 billion per year in interest costs forever, unless we actually start reducing the stock of debt.

So our great, great, great, great, great, great, great grandchildren will be paying for the debts we have run up, most of it in the last 8 years.

Mr. GLAUBER. That is why I think all of us have to be committed to deficit reduction to drive down the increase in the debt, and perhaps 1 day even to reduce the debt itself by having a surplus.

Mr. MOODY. Thank you.

Chairman ROSTENKOWSKI. Mr. Jacobs.

Mr. JACOBS. Mr. Glauber, I have just two questions. The first one is of all the parts of your job, is it fair to assume this isn't your favorite?

Mr. GLAUBER. I enjoy this greatly, yes.

Mr. JACOBS. And my second question is now that Mr. Reagan has got his $2 million from the Japanese for two 20-minute speeches, does Treasury favor resuming the traditional taxation for portfolio investment income by foreign nationals in the United States?

Mr. GLAUBER. Mr. Jacobs, I think that is a question I am going to have to defer to comment on.

May I answer that for the record, please?

Mr. JACOBS. Sure.

Mr. GLAUBER. Thanks.

[The information follows:]

The 30 percent withholding tax imposed upon payments of portfolio investment income to nonresidents was repealed in 1984 with respect to portfolio interest. Prior to 1984, United States borrowers were able to avoid the application of this withholding tax by issuing debt indirectly through a foreign financing subsidiary (for example, a Netherlands Antilles subsidiary) eligible for the benefits of an income tax treaty providing a withholding tax exemption. The statutory exemption for portfolio interest was enacted in 1984 to improve the ability of U.S. borrowers to access the Eurobond market directly. The Treasury Department remains concerned that U.S. borrowers have direct access to this market, and we do not favor reimposition of a 30 percent withholding tax upon payments of portfolio interest to nonresidents.

Mr. JACOBS. Thank you

Mr. ARCHER. Will the gentleman yield?

Mr. JACOBS. Sure.

Mr. ARCHER. I thank my friend from Indiana for yielding.

A few minutes ago, apparently there was a great deal of comment about how all of this problem of the savings and loans is a bailout of Texas, and our economy in Texas.

And I would say to those who have expressed that view, that the funds that are being committed for the savings and loan crisis is to bail out the depositors who have taken advantage of the higher interest rates of the Texas savings and loans, depositors who have brokered funds from New Jersey, from New York, from Massachusetts, and from other States across the country. They have sent bags full of deposit money to the State of Texas to take advantage of the higher interest rates that were being paid over the last several years.

And it's those depositors in those affluent, Northeastern States that are being bailed out, not the State of Texas. That money is going directly into the States of the depositors, not into the State of Texas. And I would just like to state——

Mr. GUARINI. Would the gentleman yield?

Mr. ARCHER. I would just like to state that for the record and be sure that it is understood by the people of this country.

I thank the gentleman from Indiana for yielding.

Mr. GUARINI. Do you yield, Mr. Jacobs?

Mr. JACOBS. Where are you from?

Mr. GUARINI. New Jersey.

Mr. JACOBS. OK.

Mr. GUARINI. There is no question that we want to help other parts of our country, but you are saying that the money goes up North. There is a transfer of wealth here, no matter how you look at it, to the institutions in Texas, which will be benefited by $59 billion.

Now, what I am saying is that if we are going to transfer money around our country, we want to have some kind of parity, and if we are going to help the institutions in Texas, will Texas help, giving some kind of fairness, through noncyclical funds which will be able to help the social programs and the housing needs that we have in the Northeast.

It all cannot be one way. When you talk about clean air, when you talked about——

Mr. JACOBS. It's my time.

Mr. GUARINI. When you talk about going on welfare——

Mr. ARCHER. If the gentleman would yield further——

Mr. JACOBS. Just let me make one comment. I think I can straighten this thing out right now.

I hate to see the rekindling of the Civil War, and if you need something for housing in New Jersey, and you want Texas to contribute, let me remind you of one of the component parts of concrete—they have a lot of sand in Texas.

I further yield.

Mr. ARCHER. I would simply say to my friend—I thank the gentleman for yielding—from New Jersey, that if you will trace the source of the depositors who are being insured and receiving the benefit of taxpayers' money, that you will find that the majority of them are outside of the State of Texas, that they are brokered funds that were sent down from Newark and New York and Boston, and they are the people who are getting their money as a result of the Federal guarantees.

So the money is flowing back into those States, not in the State of Texas.

Mr. GUARINI. That is not so.

Mr. ARCHER. Because this money is not being used to shore up any savings and loans. It's being used to pay off depositors.

Chairman ROSTENKOWSKI. The time of the gentleman has expired.

Mr. Russo.

Mr. RUSSO. Thank you very much, Mr. Chairman.

Mr. Glauber, I guess you got a little breather there from the heavy hitting that you took earlier.

Let me just make a couple of statements. I have no intention of supporting the debt limit either. The reason is that for years the Republican administration, and Republicans in the House and Senate relied on Democrats to do the responsible thing, to do what is necessary and right, and every time election time comes along, we get criticized and crucified by our opponents.

So I think there are some of us who feel that this disingenuous attitude just makes it difficult for us, at least for this Member, to come to the well again and say, I am going to vote for this debt limit, when I did not vote for the policies that created this debt limit.

One of the tough things that I have had to deal with is when Ronald Reagan came on his white horse and shiny saddle, came to Washington, D.C., the new wave of conservatism was so euphoric over here that we had this notion that by 1984 we would balance the Federal budget and so voodoo economics was enacted in the first year of President Reagan's ride on the white horse.

Not only did we not balance the budget by 1984, David Stockman, his 10 OMB director, said we would see $100 billion deficits as far as the eye could see if we put this program into place.

I don't know what your position was back in those days in the Reagan administration, so I am not——

Mr. GLAUBER. I was a school teacher.

Mr. RUSSO. Well, good. To your credit.

We have been sliding by the problem for 8 years. We have been living on this good feeling, happy go lucky times, everything is wonderful. Ronald Reagan convinced everybody what a great feeling we all ought to have to be living with in this great country because he was there and he was going to balance the budget.

Let me tell you what happened; 1981 tax bill, the famous 1053 or the thing that was going to turn around the country, the thing that was going to create more money, create more jobs, this year alone the 1981 Tax Act is going to cost us $357 billion in lost revenues, $357 billion.

It may come as a shock to you and some of the people who are listening to this, that in the 8 years Ronald Reagan was President, he put through 10 major tax bills. Those 10 tax bills—that were supported by the way by Democrats and Republicans and in fact, in most cases percentage wise, more by Republicans than Democrats, although we are labeled as the big tax and spend party, total $148 billion in new revenues this year.

So the Reagan tax cut for the rich and the wealthy in 1981 gave them a break of $357 billion this year. We took back $148 billion this year, so we are left with the deficit of $209 billion this year,

just from that revenue bill, of 1981, that was supposed to balance the budget by 1984.

Let me tell you what happened. Since 1980 to 1990, the cost of living in this country has gone up 68 percent. Spending for transportation has gone up 37 percent. Spending for education has gone up 47 percent. Spending on Social Security has gone up 112 percent. And defense spending has increased 121 percent.

But the biggest increase has been the increase on the debt, interest on the debt, which has gone up 251 percent.

Now, we have been sliding by this problem with a conservative Republican regime in the White House that says it is going to balance the budget and now wants a constitutional amendment to balance the budget, when in the 8 years of Ronald Reagan he never proposed one, and so far in the 1 year of George Bush, he hasn't proposed one.

So it's kind of hard for those of us who are sitting here to say well, if they are all serious about constitutional amendments to balance the budget, why don't you just submit one?

If we pass a statute tomorrow, both in the House and the Senate, and we send it over to the President and said, Mr. President, here is a statute that requires you to send us a balanced budget next year, would he sign the bill?

Mr. GLAUBER. The Director of OMB has testified in support of that bill.

Mr. RUSSO. Then he would support a statute that would make it effective next year.

Mr. GLAUBER. He testified as I understand it in support of a balanced budget amendment.

Mr. RUSSO. A constitutional amendment to balance the budget conveniently would not take effect until 1993.

I am saying let's pass a statute today that takes effect for fiscal year 1992, which would require the President to do it. Would he sign that bill and would OMB support it, and would Treasury support it?

Mr. GLAUBER. Mr. Russo, what we have in front of us is the amendment on which Mr. Darman testified.

Mr. RUSSO. Mr. Darman has said publicly, as I understand it, that he would suggest to the President that he veto the statute, which again adds to this whole hypocrisy.

If everybody is really serious about balancing the budget, we ought to do it and quit fooling the American people, because that is why they don't have much faith in Democrats, Republicans, Independents, White House people, the public has heard for 9 years that things are getting better, and everything is getting rosier; but the deficit is getting higher and higher. And that is why they don't trust public officials any more.

And all we can do is keep feeding to that by coming up with rosie scenarios and budget balancing amendments, line item vetoes when what it would take is both Congress and the White House sitting down and doing the job responsibly without having to take the political flack for doing the right thing.

Mr. GLAUBER. I think the chance for all of us is in the summit negotiations.

Mr. RUSSO. I would feel very good, Mr. Glauber, if that were true, and I would feel good if I knew two-thirds of the Republicans would vote for whatever came out of this conference.

But the problem is that you have the number two Republican leader saying that he is not going to support anything that is going to hurt his party. And that is unfortunate, because I think what people ought to do around here is do what is right for the country and take care of your party, second.

And that is why people like us, like myself and Byron Dorgan, are probably not going to support the debt limit because again, all it does is feed into the hypocrisy.

Mr. GLAUBER. I hope enough people will, because the thought of a default on the Government's outstanding obligations in my mind is just catastrophic.

Mr. RUSSO. I understand that serious problem, but it's a serious problem that hasn't been addressed for 9 years, and is one reason why interest rates are higher today than they would be because we have to keep them high enough to attract the Japanese and West Germans to come in and borrow money which we never had to do before the Reagan revolution came in.

And now unless we keep them high, we are not going to get them. Fifty percent was not existent before Ronald Reagan came to office. No matter what you want to say about the Democrats the fact is that the United States was a creditor Nation, and now it's a debtor Nation, and this is the record that unfortunately George Bush has to deal with because for 8 years, his President didn't deal with it. And now this President has to face it.

I thank you for putting up with my comments.

Chairman ROSTENKOWSKI. Thank you, Mr. Glauber.

That will conclude this session. I want to renew my request that you give me a monthly breakdown as to just what you envision the increases to be.

I am sure that you are going to make a full report to Secretary Brady. Tell him we missed him.

[Treasury's response follows:]

Following the hearing, Treasury staff contacted of the Ways and Means Committee. The Treasury indicated that a temporary debt limit of $3,195 billion would be sufficient for the period through October 1, 1990. With a $3,195 billion temporary debt limit, the Government would likely run out of cash when Treasury bills matured on October 4, 1990.

Mr. GLAUBER. I will tell him. I missed him, as well.

Mr. GIBBONS. Mr. Chairman, I have a trivial question. Could you tell us how President Bush voted when he was on this committee in 1969 and 1970, on the floor on these issues?

Mr. GLAUBER. Again, I said I was a school teacher. I did not teach history. I taught finance.

Chairman ROSTENKOWSKI. The hearing stands in recess until 1 o'clock.

[Recess.]

Chairman ROSTENKOWSKI. The committee will come to order.

This afternoon we will hear from two budgetary experts, Paul Volcker, who I certainly don't have to introduce to this committee, and Felix Rohatyn.

In my solicitation of Mr. Volcker to join us this afternoon, I told him that it would be a very informal meeting, that we would like to pick his brain about his views on how we got into this dilemma that we are in. And I might tell you, Paul, that this morning we had the Under Secretary of Treasury, Mr. Glauber, in, and he told us about increasing the debt ceiling by about $700 billion for the next 2 years, and that didn't go over too well with many members of the committee because it is just borrowing, as opposed to raising taxes and financing; it is borrowing.

Another issue naturally that causes us great concern is the savings and loan debacle. I think that to lay this on future generations is something that is quite unpalatable to me. I hope that you could give us an idea of how you view the world, and what you could suggest to us, or what approaches we could make to help solve this dilemma.

You know, I would like this committee to continue the atmosphere as much as possible of being committed to trying to solve the problems that we find ourselves in, and laying aside the political snowballs as much as possible.

So, having said that, welcome, once again, to our committee, and we are looking forward to the conversation that is going to take place.

Paul.

STATEMENT OF HON. PAUL VOLCKER (FORMER CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM), CHAIRMAN, JAMES D. WOLFENSOHN, INC., NEW YORK, N.Y.

Mr. VOLCKER. Well, thank you, Mr. Chairman. I appreciate being here. And I was going to say it is familiar—and it is generally a familiar setting—but I don't recall those fancy water pitchers when I was here before. You have had some additions, but you certainly have familiar problems.

My experience with debt ceilings goes back at least as far as yours, I suspect, when I was in the Treasury in the early 1960s. Deficits, budget summits, even savings and loan crises—these days I must say I observe it all from a distance, without staff, without numbers—but the nature of the problems seem unfortunately familiar enough.

I would like to largely respond to questions, but let me just make two points, one about savings and loans, and one about the general economic and budgetary situation.

In many ways, I think it is fair to say the economy has performed very well in the past 7 or 8 years after the inflation and after the recession of the late 1970s and early 1980s. But in another way, and from the long-term view, that ought to preoccupy all of us, its performance has not been very good.

Productivity really hasn't recovered during this long expansion and languishes at about 1 percent growth a year or a little more. The rate of net business investment is low. Interest rates have been historically high, not just in nominal terms, but in real terms. I think to some degree, all these phenomena are related and they are related to some extent to the budget deficit.

You asked for one single measure that is needed to put us on a better long-term course. I think you are worried about the right problem when you worry about the budget deficit and how to cure it.

I have developed a certain amount of skepticism over the years in our ability and willingness to deal with this problem straightforwardly. Maybe I am absolutely hopelessly naive, but hope does spring eternal; I do see some things that give me a little hope that maybe this time you will put together a program to make some real progress and begin working on these very fundamental problems.

I think part of that, frankly, is the initiative that you yourself, Mr. Chairman, took a few months ago in putting together a budget program. That program posed very difficult political issues, but I think it had the kind of comprehensiveness, however one wants to argue about the details, that this requires.

More recently, of course, we have had President Bush's statement. It ticked off very briefly the essential elements that must be contained in any comprehensive approach, including, I think quite properly, his emphasis on some mechanisms for keeping spending under control over a period of time, particularly in the context of talking about revenue increases or tax increases.

So I do think that it is still important to make some progress, and maybe there is some hope this year. Maybe the savings and loan thing with the outlandish numbers involved, help bring it to a point of decision.

Let me just make a couple of comments on the bookkeeping of that. I can't give you any expertise about how big the numbers are, but we all know they are big. I have no reason to quarrel with the numbers that the Treasury has put out. I do think, so far as those figures are about ultimate losses, they are a proper budgetary charge.

I don't like the precedent of not dealing with these things on the budget. It has a peculiar implication in terms of timing; in effect, the expenditures were made some years ago when the losses were incurred. We didn't know it, but the losses were being incurred and that is when the impact on the economy took place. Now you are replacing one kind of obligation, an insured deposit with another, a Treasury security.

It seems to me that should be reflected in the budget, but shouldn't necessarily be something that you feel has to be offset in the short run by other spending cuts or by tax increases. The transaction is not going to affect the economy at the moment; it is an exchange of assets, exchange of liabilities for the Federal Government, an exchange of assets for those receiving the new securities.

What you need is a program I think to bring us into balance or surplus over a 4- or 5-year period. In that context, this bulge in these expenditures will wash itself out. I think that is the essential point that I would make on the bookkeeping of it, Mr. Chairman, and I would be glad to engage in conversation.

Chairman ROSTENKOWSKI. Well, I am sitting in on the budget summit, and I must admit that this is about the third time I have been in a summit. I constantly worry about those of us who sit

there and agree on all the points after having been exposed to the debate for a month, but when we come out and start talking about them fresh with our colleagues, those colleagues aren't as enthusiastic about doing as much as we want to do. The conversation is constantly, "What are we going to do about spending," and maybe that is what I hear most with respect to a floor or a ceiling. And then we never talk about what we are going to do if revenue estimates are off. I mean, that is part of the equation, too, as you know, an economy can falter.

But the savings and loan situation has just blind-sided us, I mean to a point where one is not the most popular individual discussing with mayors of various cities, or charitable institutions, the fact that their peace dividend has already been swallowed up.

Now, maybe it is because I have been here as long as I have, but I don't sugar-coat things when I sit and talk with mayors or when I talk with county commissioners or Governors, for that matter, because I think that they have to face reality when you are talking about numbers that are devastating in one industry, and that is part of what we view as a big problem here. In this morning's testimony, we were not talking about solving problems, we were just talking about borrowing money again, and there has to come, there has to come a time when we are going to face reality.

I hope that this summit does come up with a solution that is going to be somewhat acceptable to our colleagues on both sides of the aisle, because it is not one side of the aisle or the other side of the aisle's problem, it is a problem that all of us share.

I think, however, that what we are going to have to do is compare what in fact sequestration means as opposed to an alternative that we could create. And in most instances, anybody that talks about a $100 billion sequestration is talking about a recession in the next 6 months, because I just don't think that we can, the country can, absorb that.

Having said that, Mr. Downey, would you like to make a statement?

Mr. DOWNEY. Thank you.

First of all, I am delighted that Mr. Volcker is here. I remember when he was able to probably more effectively than any other person that had ever testified before this committee dodge the tough questions and give us some of the best circumlocuted answers I have frankly ever heard.

Mr. VOLCKER. I was just explaining the complexity of reality.

Mr. DOWNEY. I appreciate that reality, and I also appreciate the yeoman work that you did on the Federal Reserve Board, because I believe it is under your tutelage that we were able to break the back of inflation, and I think that future generations of Americans owe you a very deep debt of gratitude. And it is a firmly held belief of mine that without your presence, this economy would be in far more disastrous shape than it is.

I want to ask you some generic questions, if you would, Paul, about this idea of whether this is a country that should be optimistic or pessimistic about the future.

There have been a whole variety of books written recently by so-called optimists who say, well, don't worry about this debt. As a percentage of GNP, it is not high. It has been higher. World War II

was cited as one example of when it was higher, that we have had this sustained period of growth, that we still remain competitive.

Yesterday there was an article in the Wall Street Journal about how our balance of trade with Europe is improving, and that certainly is good news. One would have never thought that Timber Lake shoes could have played such a role in changing that balance around, but apparently we are making things in this country that the Europeans want, and that is all to the good.

But what concerns me, and what concerns I think the chairman and the other members of this committee is the fact that we have a sneaking sense that we are not on the right path, and I want you to, if you would, embellish that point, if you agree with it.

Second, that while it is true we need to restrain our spending appetite in certain areas, there are other areas that desperately cry out for our attention. I talk about the paucity of real investment that we place in children. One out of five of them is poor, 2.6 million of them were abused or neglected in the last year, we are 12th in math and reasoning skills, right above the Hungarians.

Money will not serve all of those problems well, nor will it solve them. But it seems to me that an investment in our people and in our infrastructure, notwithstanding the current state of affairs with our deficit, are very, very desperately needed.

I would ask you if you could provide, as you have in the past, some balance between some of those spending needs and some of those spending restraints.

Mr. VOLCKER. Well, you covered a big area. With respect to your first observation, are we doing well or poorly, I suppose reality is always mixed. But as I hinted at, at least, in my opening sentences, we are not doing as well as the optimists would like us to believe at times.

We have had a very long period, a record period, of business expansion, low unemployment, and inflation lower than it was, although it is still clearly a problem. What bothers me, as we look toward the future, is we are clearly not investing enough. Our productivity is low by world standards, our savings are low by our own past standards and abysmally low by world standards, and all these things are reflected in a relatively less vigorous economic performance internationally than we should be having. I think all that feeds back on a feeling, a psychological feeling, that somehow after 7 or 8 years of expansion we are poor.

We are richer than we have ever been in statistical terms, but people feel unhappy. They feel unhappy I think because real incomes per capita are growing very little. Real wages are tending to fall.

And I think there is a sense that we have great needs in some of the areas that you mentioned—education, infrastructure. We can't seem to find the money to spend on them, even though by some objective measures we should be richer than we were before. We are not getting, in the world league ahead as fast as we should be, and I think this bears on our whole leadership posture in the world.

I think it is a serious problem at a time when very favorable changes are going on in the world potentially. Is the United States

is in a position to take the kind of lead that we should be taking to assure that this constructiveness is fully realized?

On your point about—am I supposed to stop when this thing gets red or orange or whatever?

Chairman ROSTENKOWSKI. No.

Mr. DOWNEY. That is for me, Mr. Volcker.

Mr. VOLCKER. Let me make one point on expenditures. You can't come from New York City without thinking there are areas where we have public needs for expenditures in many directions, education, and infrastructure are two. The drug problem is another.

I suspect that there is so much reluctance to spend for those things partly because you are locked in a kind of political impasse on how to deal with the deficit, but also because there is a lack of faith, which has. Some justification, that the Government won't spend the money efficiently. It doesn't spend the money efficiently on some programs that it has, some programs should be reduced—and I personally think they certainly should be—so how can we give those fellows down in Washington more money to spend, even in areas where it seems to be necessary, when we don't have faith that they are going to economize where they should be economizing?

I read into that, as part of the overall settlement, we need some ingredients that provide some reassurance on that score. You can't do everything in one budgetary settlement. But I think there is a legitimate concern that if we are going to provide more money for things that I think are urgently needed, we better have some mechanisms or some procedure or some confidence that money is going to be cut back where it is not so desperately needed.

Mr. DOWNEY. One of the statistics that we publish in our green book, which is our book of compendium of information and statistics about the items within the jurisdiction of the Ways and Means Committee, deals with the income aggregates over the last few years, whether or not the rich have gotten richer, the poor have gotten poorer, and one of the I think most compelling statistics, and I preface this by saying that I am a capitalist and I am delighted by people who are rich, have done well, but if you look at the statistics, the top 10 percent of earners in 1977 in real dollars earned about $210,000, all sources, on average. They make $550,000 today, a real increase of 94 percent.

And if you take a look at just the top 10 percent, the real earning power of these individuals has dramatically increased, and if you take again that top 1 percent, you will see that taxes over income declined 23 percent, and if you look at all other income brackets, down from the top 10 percent, real wages have not increased, with the exception of the bottom quintile which has gone down in real terms 9 percent, and their taxes have increased or decreased slightly.

It seems to me that there is a social phenomena here that we can't negotiate, and as Democrats, we are always charged with the fact that we want to raise class issues.

I am concerned that in the process of taking down the top rate from 70 percent down to 28 percent, that we have visited upon people with income in this country benefits that we have not bestowed on others. And I wonder if it isn't appropriate as we look

for additional revenue, which I believe we desperately need, and I would do a number of things, and energy tax is something I could be in favor of, which would hit everyone, but it seems to me appropriate to take a look at this top rate as a potential source of income, and I would ask you if you would respond to that as whether or not you think it is appropriate and also if you would add addendum on the question of capital gains proposal, which the President continues to offer us as a way to grow and invest in the country.

Mr. VOLCKER. Well, I have a little bit of mixed feelings about that question, because it involves a lot of noneconomic judgments about economic decisions.

There was a great debate upon the structure of the income tax, as you well know, 2 or 3 years ago when that tax act was put into law. There was a general feeling that we ought to broaden the base, sharply reduce the top bracket rates, and put it in place for a while and see what happened.

I think it is totally arbitrary as to whether that top rate is 28, 30, 27, or 32 percent, in that neighborhood. It is a big reduction from what it was. But once you begin tinkering with the thing, it raises a lot of other questions, and you lose a little bit of the feeling, let's see how it goes for a while with this sharply different income tax environment.

Then we have the capital gains tax question raised. That was part of the deal, it seemed to me, 2 or 3 years ago—you got rid of the capital gains tax and in return for that a very sharp reduction in the highest marginal rates.

I come out that I think there is something to be said—in political terms, speaking partly as a politician now, which is your business, not mine—that if you do consider—and I understand the argument for the capital gains tax reduction—that that reduction is a priority, then it quite properly and equitably opens up the question of the top bracket again. I am not talking about a large amount, but you have got the so-called bubble question too. In that area, it does seem to me it is reasonable to talk about changes.

Chairman ROSTENKOWSKI. Mr. Matsui.

Mr. MATSUI. Mr. Volcker, I frankly didn't understand your answers to Mr. Downey there. I think he asked you whether or not you favored a change in the top rate, and second, I thought he asked you whether or not you support or oppose a capital gains differential, and I am not sure if I got a response to that.

Mr. VOLCKER. I think my answer is I can live with it the way it is, and I think that was the deal that was made a couple of years ago, but I am talking politically.

If you do do the capital gains tax reduction—which has got substantive arguments, very real arguments in favor, particularly in my mind on longer term investments—then I think it is legitimate to raise the question of the top bracket rate, which was part of the original deal. At the same time, let's take care of the bubble.

Mr. MATSUI. Do you think that capital gains differential promotes economic growth?

Mr. VOLCKER. Yes, I think it reduces the cost of capital, and if you do it for particularly longer term investment, I would expect that it does have some effect. You can argue about the magni-

tude—but there should be some effect in encouraging a certain type of risk taking, which is good for the economy.

Mr. MATSUI. Let me ask you another question. We are going to be taking up a constitutional amendment to balance the Federal budget next week. It wouldn't come into effect until 1993, that is at that time we would have to have a balanced budget.

Do you have a position on that, and if so, what is it?

Mr. VOLCKER. My position has been opposed to it. It is a kind of—it is hard to call a constitutional amendment a gimmick—but you are substituting words of unknown effect in the future for the kind of action you should be taking today to really affect the budget.

I am more interested in what you do now and over the next few years toward in fact seeking a balanced budget than words that you put in the Constitution, words are going to be very difficult I think to implement.

I don't see the Constitution as an appropriate vehicle for legislating economic or budgetary policies. It should focus on procedures and fundamental liberties, if you will, in my view, rather than this kind of thing.

Mr. MATSUI. I would like to ask you, assuming that the Congress in its wisdom decided to pass such an amendment and the States ratified such an amendment, do you think under any circumstances, given the projection that you might have on the economy over the next 36 months, and knowing the magnitude of our problem here at the Federal level in terms of the deficit, do you think that we can balance the budget by 1993?

Mr. VOLCKER. By 1993, I think would be pretty tough. By 1995, OK.

Mr. MATSUI. I appreciate your testimony.

Again, I would like to say what Mr. Downey and the chairman have said, that over the last decade I think you have performed a great service to our country in terms of keeping our economy on a pretty even keel. The only downside of what you have done frankly was that you allowed the Congress and the President in particular to be irresponsible by your rather statesmanlike actions in terms of monetary policy.

I would like to make one further observation that doesn't pertain to you, Mr. Volcker. Earlier this morning a number of my colleagues indicated they would vote against the debt limit, and I must say that I might be inclined, should the chairman lean on me a little bit, to be one of the votes that support this debt limit out to committee on the floor of the House, but I certainly do not intend to vote for it when it hits the floor of the House, and I hope that is a signal to my Republican colleagues because they are going to need an awful lot of votes—I believe this time around $700 billion worth of votes—to get this one passed. I am prepared to stay here through August and through the rest of the year to deal with this issue.

Mr. VOLCKER. I assume you would feel differently if you had a budgetary settlement.

Mr. MATSUI. I don't know if I would, because it depends upon the mix of it frankly. If it is the budget that Mr. Bush proposed to us in January, I certainly wouldn't be inclined to. But if we have

something that is in line with Mr. Rostenkowski's February proposal, perhaps then it might have some realistic possibilities.

Chairman ROSTENKOWSKI. Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman.

Welcome, Mr. Volcker.

Mr. VOLCKER. Thank you.

Mr. MCGRATH. I am not one who signed on to the list of 90, who have told the President that they will not vote for any revenue increase under any circumstances at all, and frankly, I am doing that to be part of this committee. I can't imagine that the chairman of this committee would take me seriously if I signed on to something like that and precluded any judgment that could be made in the future about the viability of any proposal.

My understanding is that the budget summit is going to raise revenues. I think the President came to realize that if he expects a certain amount of savings in that summit decision from the people on the other side of the aisle, they are going to insist on some revenues. Those revenues ought to be part of that package also, and that is basically what I want to ask you about, what kind of revenues that you think ought to be considered in that particular piece of the package?

Let's say, for instance, that we are going to chop off the real deficit without Social Security of about $250 billion—$50 billion a year off for the next 5 years. In the mix there might be somewhere between $25 and $50 billion in savings, and $20 and $25 billion in increased revenues. Where do you think we could be most productive for the economy, and frankly politically speaking, where do we go to get those revenues?

Mr. VOLCKER. Well, let me make one preliminary comment. You talk about the other side demanding revenues. It may be the circumstances that demand revenues, if you are going to get that kind of target savings on the deficit you mention, which I agree with as a general kind of target. If you get all the savings in expenditures, fine, but I don't think anybody can do that, is my pragmatic judgment.

So far as the revenues are concerned, I would lean, maybe entirely, on excise taxes, and whatever loophole closing remains, which I suspect that is pretty small. I suppose it is easiest to get the consensus on the sin taxes, and that is fine. Do that, and it doesn't raise all that much money, but, it raises a useful amount.

Mr. MCGRATH. $2 to $3 billion, maybe.

Mr. VOLCKER. If you are not going to go to broad-based sales tax or value added tax—and that takes time, and there are arguments against it—I suspect you are going to have to rely a lot on some kind of energy taxes. You have either got to make the gasoline tax, think of something between 25 and 50 cents additional, or do a broader based energy tax, which a lot of people would prefer.

Mr. MCGRATH. A Btu kind of tax?

Mr. VOLCKER. Just how you do it, I don't know, I am not an expert. I think the easiest thing to do, partly for simplicity, is a gas tax. You already have it, you know what it is, you know the conservation arguments in favor of that.

Mr. MCGRATH. Well, the gas tax will get you somewhere around a billion dollars for every penny.

Mr. VOLCKER. That is right. So if you do $25 billion, if you do 25 cents, $50 billion if you do 50 cents, I am not talking abut doing it all tomorrow, but you are talking about doing a 5-year program.

Mr. MCGRATH. You are not speaking in terms of any increases in marginal rates on individuals or corporations?

Mr. VOLCKER. I think you can probably avoid that.

Now, we talked about this question of the capital gains tax and whether, in return for that, you raise the top bracket rate, but you are not talking big dollars there. That is partly a political——

Mr. MCGRATH. $10 billion for every person across the board.

Mr. VOLCKER. If you raise the whole tax rate across the board. I would hope, frankly, you could avoid that, and—it has been a long time since I reviewed these figures—I certainly think you could avoid it for a couple of years. You can get the kind of revenues you need without going to the income tax in an important way, without going to the general tax rate, anyway. And I would certainly attempt to go that way, and I think you probably can.

Mr. MCGRATH. I thank you, Mr. Volcker.

Mr. VOLCKER. If you really thought—I am not there—but if you really thought the Government needed another $50 billion of something kind of revenue permanently, I would then seriously think about the value added tax.

Mr. MCGRATH. One further question. In regard to this S&L problem, do you believe that it requires a dedicated stream of income over, let's say, the next 5 to 7 years, rather than to borrow to the extent that we are borrowing?

Mr. VOLCKER. I would tend to exclude the expenditures involved in the savings and loan thing not from the budget, but from an assessment of how to close the deficit. I think it is a temporary bulge that will not affect decisively, or importantly, economic activity in the short run. It doesn't divert resources from other uses. They have already been diverted.

Mr. MCGRATH. On budget, off Gramm-Rudman.

Mr. VOLCKER. I agree with on budget, because it should be reflected in a charge to the taxpayer. However, the timing isn't right from a fiscal impact point of view. The charge on the taxpayer took place some years ago. We didn't realize it, but it took place when the losses took place.

I don't think you want to come along and cover that bulge with additional taxes, let's say, or with a drop in some other expenditures. But I think it ought to be reflected on the books. It is a continuing drain on the taxpayer from the interest that will be paid on all that borrowing.

Mr. MCGRATH. In your view, it should be disregarded in terms of our budget crisis?

Mr. VOLCKER. If you keep Gramm-Rudman, I would take it out of Gramm-Rudman. That is what I would do.

Mr. MCGRATH. Thank you.

Chairman ROSTENKOWSKI. Mr. Cardin.

Mr. CARDIN. In response to Mr. Downey's question, you indicated that one of the difficulties we have in convincing the American people of additional need of investing in our people is the lack of confidence that the money is being spent properly. I think the same concerns are expressed, at least in town hall meetings that I

attend, on whether the new revenues would be used to reduce the deficit, or whether it would be used somewhere in the Federal budget, for some other purpose.

And quite frankly, you can even take it one additional step, and that is people are very confused about the Federal budget deficit, exactly what it is, because of all the different numbers that we put out. If I understood your response, you were saying that in order to overcome that, or at least to start to address that issue, that the budget summit should come out with some recommendations in that area.

I was wondering if you could expand a little bit more as to what is needed to restore public confidence.

Mr. VOLCKER. I myself—I know it is very controversial—think that this is a good opportunity to introduce a line item veto on a temporary basis. I am not now talking about amending the Constitution. Try it out and see how you like it during this period of budgetary restraint.

Either that, which seems to me the most straightforward thing to do, or provide at least some kind of revision authority to the President—some of the things that were taken away years ago—so that at least you have some kind of effort moving in the direction of achieving better control. In effect, you would be putting it up to the President a little more directly to exert some of this expenditure control, seeing what he can do with a little more flexible authority.

Mr. CARDIN. On the credibility issue again, on the way we spend, there are many of us who have been suggesting a more straightforward definition of the budget deficit, particularly as it relates to the Gramm-Rudman law, with the use of the Social Security surplus, no one can argue with the economic impact of those dollars, but the fact that it has allowed the operating deficit to become much larger is certainly not what was intended.

I am wondering whether you have any views as to whether recommendations in that area are helpful in trying to move us forward in really dealing with the deficit.

Mr. VOLCKER. Well, the trouble with a single budget deficit number, is that you want to use that number for a variety of different purposes. For purposes of economic analysis, the way we do it now, it is probably appropriate.

I am reluctant to see the budget redefined without the Social Security surplus, although, if you are looking at, looking at it from a different point of view—and particularly looking at it from the point of view of building up real surpluses of savings that are going to help with the Social Security problem 50 years from now or 30 years from now—we should take it out of the budget and put it in a separate trust fund.

My conclusion would be I wouldn't fool around with the budget definitions, but the Social Security surpluses reinforces the view we should be running an overall surplus. Those Social Security surpluses should be reflected in an overall budget surplus, not a deficit. We should, in the rest of the budget be coming much closer to balance or be in balance.

I agree with the substance, of what I think you are saying, I don't know whether you want to change the definition or not. But

as it is now, we are kidding ourselves. Those surpluses are not really surpluses in the Social Security fund that are being effectively invested in ways that will reduce the burden on the taxpayer 20, 30, 40 years from now.

Mr. CARDIN. I certainly agree with that. I guess the point is this year we are going to have to clearly modify the Gramm-Rudman law in some form. We are not going to be able to meet those targets, even if we have a successful budget summit. So it may be an opportunity to try to at least clean up the definition during the remainder of the life of Gramm-Rudman for as long as it should live.

One last point, if I might. I understand, I think, your point in regards to the savings and loan bookkeeping, the fact that a deficit reduction package that comes out of the summit could succeed in really addressing the deficit of this country without taking on the savings and loan problem itself. But couldn't that same argument then be used in a lot of other one-time-only expenditures that we have at the Federal level?

Mr. VOLCKER. Well, that is why I would not take it out of the budget per se. Forgetting about a timing problem, it is a charge, in a larger sense, for a charge like any other charge on the taxpayer; it cost them money, it cost real resources, they have to pay for it either by borrowing or preferably by taxes or by reduced other expenditures.

It is just that the timing comes all in a lump, unrelated to the underlying expenditure that we didn't recognize at the time. A $50 billion budget program, is probably the right order of magnitude as a round number. Another $50 billion, let's say, to pay for the bulge in the savings and loan thing, would give you a $100 billion real budgetary program. That may be too much, even for me.

Mr. CARDIN. Thank you, Mr. Volcker.

Chairman ROSTENKOWSKI. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

Welcome. Let me just, if I might, go back to your original statements about the extent of the crisis. Because what you say today maybe matters in a different respect than when you were chairman of the board and we tried in various committees to pin you down. But it has some real importance trying to set public understanding and opinion on the nature and the extent of the crisis.

I am not sure how people who heard you will judge how deep a hole we are in today. And I know that you have always wanted to avoid overstatement and scaring the dickens out of people and the market, but I do think if we are going to move ahead and make the summit a success, we have to be clear about the nature of the problem. If we are not, we can't expect the public to respond.

And I think you send very mixed signals. You start off by talking about how similar the settings were today with the past, and you threw into that category, at least you seemed to, the S&L situation. So if you would, go back over it, and if you would, give us your succinct feeling as to the urgency.

How urgent is it that we move to cure this deficit? How devilish is this deficit, or is it just—I mean, as you said, well, the settings are similar.

Mr. VOLCKER. I understand your frustration, but I have done my share of attempting to ring the alarm bell some years ago. I have

been a little surprised that things have moved as smoothly as they have moved. We have had our share of potential crises, we had a 500-point drop in the stock market, and we have had this whole savings and loan crisis blow up on us involving huge, unimaginable amounts of money. Strains on the banking system, volatility elsewhere in the dollar as well as in the stock market, a major investment firm going bankrupt, and the economy has continued to go on. In that sense, it is hard to use the word "crisis," because the crises have been very localized. I can't tell you that that isn't going to continue to be the case, although I think all those events to some degree are outgrowths of our tendency in recent years to spend more than we are producing and to get heavily in debt, both domestically and internationally.

What you can say—and it is less dramatic, but I think that is where we are—that it has been a very debilitating period of relatively low investment and low productivity. That is pretty fundamental stuff. Unfortunately, it seems a little abstract to the average voter, I understand that. What he sees is that his real income is not increasing, and he feels frustrated. He is not relating that to the budgetary situation, but I think it is substantially related. It is a very hard point to make. But that seems to be the fact of the matter.

I think there is some instinct on the part of the public that something is the matter. That accounts for all this unhappiness. And that is reflected in real, hard statistics of productivity and rate of growth. Our growth potentially now is 2, 2½ percent at most; it may not be that high, reflecting the cumulative effects of this disease, if it is a disease.

But unfortunately, it is not a heart attack, unfortunately from the standpoint of arousing a quick response. It is more a slow growing cancer than a sudden heart attack on the street that you can apply a little cardiac resuscitation to.

Mr. LEVIN. The Ways and Means Committee circulated a number of charts on the national debt. One of them relates to the Federal debt and the percentage of GNP, and it shows that since 1980, the national debt has grown from 34 percent, and it is going to, according to the estimates given this morning by the Treasury Under Secretary, it would grow to 60 percent of GNP. Now, I take it that is another way to describe this disease.

Mr. VOLCKER. It is a way to describe the disease, but not the way that I would describe it, I suppose, because people can say look, it grew to about 60 percent before, and country X has 70 percent. What difference does it make? We could handle the 60 percent if it was going in the right direction. What you can't handle—you can live with it, but you can't live with it very well—is this slow erosion of our economic strength internationally as well as domestically.

If people are happy that Germany and Europe generally is going to outstrip us and that Japan continues to outstrip us, that is OK. But they are not really happy with that; people feel quite uncomfortable about it, understandably. I feel uncomfortable about it. We can do something about it. But we got to make the connection.

Mr. LEVIN. Thank you.

Chairman ROSTENKOWSKI. Mr. Pease.

Mr. PEASE. Thank you, Mr. Chairman, and thank you, Mr. Volcker, for being with us today. We also enjoy your testimony.

Try to help me understand, if you will, the administration came in this morning and asked us to increase the debt limit for a 1-year period by $387 billion, fiscal year 1991. The budget summit group is talking about reducing the deficit through a combination of tax increases and in spending by perhaps $55 billion. Somehow that doesn't compute in my mind. Is $55 billion against a $387 billion increase in the national debt inconsequential? Is it a drop in the bucket?

Mr. VOLCKER. Well, I said I am far away from these things now, and I don't know how they get to $387 billion. You are going to have a budget deficit, as I understand it, including the savings and loan thing, probably running comfortably over $200 billion. How do you get from the $200 to the $387, I don't know. I assume part of the answer is whatever the Social Security surplus is, that gets invested in Government securities, and it is reflected in the debt limit.

So what you are seeing is what Mr. Cardin was talking about earlier. The Social Security surplus is in the budget, the debt increase is the budgetary deficit without the Social Security surplus. That still doesn't get me up to $387, but it easily gets me over $300.

Mr. PEASE. Well, is it possible that dealing at $55 billion at a time with deficits in that range can really do the job?

Mr. VOLCKER. Well, $50 billion alone isn't going to do the job. You are talking about the first year payment, so to speak. I think you need that order of magnitude for 4 or 5 years and then you have got to a figure which is more commensurate with the numbers you are talking about.

Mr. PEASE. I see. Part of our problem has been caused by the savings and loan crisis, as we have mentioned. Do you have any views on whether we need changes in our deposit insurance laws? There have been suggestions for lowering the amount of deposit insurance, or strictly limiting coverage to $100,000 coverage per family, or per person, rather than multiples, as we have it now.

Mr. VOLCKER. That is a very difficult area, but you asked a general question, should you be looking at that and making some reforms? It is easy to say yes. When you ask me precisely which reforms, it gets a lot more difficult. But I think I would, for instance, be inclined to do the $100,000 per family, or per depositor, rather than let them open up multiple accounts and be covered, if you achieve that result technically. I don't know whether you can in fact do that in an equitable way.

I have a favorite reform in this area, apart from better supervision and regulation—which is certainly necessary, that is easy to say and hard to implement, but is No. 1. You could require insured financial institutions, to put up substantially more capital, perhaps in the form of subordinated debentures that are clearly not insured. Whatever else happens, those particular securities will not be protected.

By that means you inject—don't make it too costly by requiring that it be equity—at least for a significant margin of their liabilities a kind of market review that becomes meaningful. The securities are presumably sold to relatively sophisticated people, and it

gives you a kind of constant market test by people that are going to be sensitive to whether the institution fails or not.

I think you can make a sharper distinction by law between deposits and other creditors generally, which is not a strong distinction now. But these are tough areas, but I do think changes should be made.

Mr. PEASE. Finally, if I might, I would like to ask you two questions relating to your ideas about which tax might be used to raise the necessary revenue.

You mentioned capital gains tax and said that in some circumstances, lowering the capital gains rate might encourage risk venture. I wonder if you could quantify that. I would quite agree with that for venture capital firms, but that represents less than 1 percent of capital transactions, and I am wondering if speculating on the stock market, selling GM and Ford and back and forth, would qualify under your definition.

And second, I wonder whether you are concerned at all in your promotion of excise taxes about the fairness of it in terms of low-income taxpayers.

Mr. VOLCKER. On the first question on the capital gains tax, I certainly wouldn't limit it just to venture capitalists, although I think it makes a difference, and most spectacularly makes a difference, in new startup and venture capital kinds of things. You can get at some of the problems that you are hinting at, I think, by making it larger or more effective for assets that are held for a period of time. You don't give it to somebody and we never have had it historically, for somebody who is literally dealing overnight. You could stretch out that time period a bit, it seems to me, to usefully get a bigger bank for the buck, so to speak.

So far as the excise tax question is concerned, if you are talking about the ones that we were talking about earlier, the sin taxes and the gasoline tax, or the energy tax generally, it may have some effects on distribution, but there are other reasons why those taxes, it seems to me, are not so bad.

We are not trying to encourage cigarette smoking in this country. We are not, presumably, trying to encourage heavy drinking. We should be discouraging excessive use of gasoline and big cars and all the rest. So you get some collateral benefits from those particular kinds of taxes, even at high levels.

If you reach the point, and I am not sure I am there in my thinking, where it needed some offsetting, then you could deal with that through the income tax. In the order of magnitude that we are talking about, I think there are independent reasons why those are--all taxes are bad—are less bad than some others.

Mr. PEASE. Thank you.

Chairman ROSTENKOWSKI. Mr. Moody.

Mr. MOODY. Mr. Volcker, you say all taxes are bad, and all borrowing is bad, and the question is which is worse under what context?

Mr. VOLCKER. Exactly.

Mr. MOODY. I wish we had had more of a discussion over the last 10 years on the fact that borrowing itself has side effects which are as bad or in many cases worse than taxes.

Mr. VOLCKER. That is the basic point I am trying to make, that we have been spending more than we can really afford, and we are taking it out of investment, we are taking it out of weakening our international position, getting more in debt internationally, which is going to cut into incomes in the future.

Mr. MOODY. For 10 years, we have been told taxes are the worst thing that can happen to people. There has been relatively little rhetoric pointing out borrowing can be just as bad or worse.

The deficit is a tax on the monetary system rather than the fiscal system.

Mr. VOLCKER. I don't want my comment about all taxes are bad to be misinterpreted. Nobody likes taxes.

Sure, they are necessary. Not much can be said about taxes except they are necessary to cover Government expenditures.

Mr. MOODY. Mr. Justice Brandeis called them the price of civilization.

When we look at what the economy can take, we are cautioned that going above $55 billion in deficit reduction could create additional economic problems.

Mr. VOLCKER. Yes.

I happen to think something on the order of $50 billion over a series of years is an appropriate order of magnitude.

There are some limits as to how hard you want to hit it at a particular point in time.

One of my worries has never been the Congress would overdo it.

Mr. MOODY. We wouldn't overdo it. We might well underdo it.

Mr. VOLCKER. The total risk is you will underdo it.

Mr. MOODY. If the Government spends $1.2 trillion but only taxes us $900 million something, we are going to have to make up $300 billions somewhere. If we pull those resources out of economy one way or the other, either through the front door of the fiscal system or the side door of the monetary systems——

Mr. VOLCKER. To some degree you pull them out of foreign economies.

We are a big drain on international savings.

Mr. MOODY. We used to worry about the brain drain overseas. I think the capital drain overseas is a major issue.

Mr. VOLCKER. We are facing a period when other countries are going to need that capital more urgently—the capital we are using.

You have got this whole phenomenon going on in Eastern Europe and Russia.

Mr. MOODY. The price of capital can only go up given the Eastern Europe situation.

Mr. VOLCKER. I think that is true.

Mr. MOODY. Which makes it more urgent to get deficit reduction underway right now rather than waiting until 1993 or 1992.

Mr. VOLCKER. I think that is absolutely correct.

Mr. MOODY. You testified on the on-budget/off-budget issue briefly. It seems to me one of the more foolish positions of this administration was the absolute insistence that the S&L bailout be off-budget on the grounds the market would react so adversely if it was on-budget.

Do you think the market was fooled by taking it off-budget or do you think the real pressures of having to borrow that much in the market, whether it be on- or off-budget were about the same?

Mr. VOLCKER. I thought at the time it was arguable—on balance it should have been on-budget then.

Mr. MOODY. Even given the rewrite requirement?

Mr. VOLCKER. Yes. And you would have to rewrite Gramm-Rudman, yes.

I take it that is the general view now after a compromise reached last year.

I think the way to handle the confidence problem is clearly to have a budget, a successful multiyear budgetary, program.

That will overwhelm in favorable effects any misconstruction of putting this stuff on the budget.

Mr. MOODY. I am glad to hear you didn't buy the rhetoric of last year about the urgency of not rewriting Gramm-Rudman, particularly since we are going to rewrite it anyway.

The numbers are so overwhelming we can't possibly get down to $64 billion.

Mr. VOLCKER. Gramm-Rudman gets rewritten implicitly every year. The expenditures after the deadlines are greater than was assumed during the Gramm-Rudman process.

Mr. MOODY. I think Gramm-Rudman has been a fiasco. We are going to be voting shortly on a balanced budget amendment.

Would you favor a constitutional amendment to balance that budget?

Mr. VOLCKER. I have not favored a constitutional amendment. Some day I will get so frustrated I will favor it.

I have not quite reached that point.

Mr. MOODY. You say if we do away with the bubble and make the top rate 33 percent, the tradeoff would be capital gains.

Since things have changed so drastically since the 1986 bill was written, isn't it arguable we should flatten out that bubble without asking for a capital gains revenue loss to offset it?

Mr. VOLCKER. If you were going to do that, I think I would do some capital gains tax reduction just to assure that investment risktaking was not impaired and you may get some positive benefit.

Mr. MOODY. What about indexing the bases?

Mr. VOLCKER. That is one way of doing it.

I have not liked indexing because of what it implies in long-term attitudes toward inflation.

Mr. MOODY. It does remove the penalty for long-term holding?

Mr. VOLCKER. That is correct.

Mr. MOODY. Thank you very much.

Chairman ROSTENKOWSKI. You are going to have to excuse us to vote.

Paul, when you talked about capital gains, you suggested a long-term capital gain as opposed to the short term?

Mr. VOLCKER. Don't ask me to draw the border line.

Chairman ROSTENKOWSKI. One more thing I couldn't agree with you more on, with respect to having presented the so-called schedule of what I thought had to be if we were going to be serious is that people don't believe us out there. They think we throw money away like confetti here in Washington.

What we have to do is convince the American people that we are going to spend their money prudently, because invariably in the question-and-answer period when I am talking with taxpayers, they say that they will pay the taxes, but they complain about the way money is thrown around in Washington. I think, generally speaking, that is our problem here.

Mr. VOLCKER. I agree with that.

Of course, part of the problem is, and you deal with it in your own proposals, is so much of the budget is entitlements. They don't tend to think of it in that context.

Nobody here this morning has raised, including me, but I will raise it right now, I don't know how you can leave that out of the program either.

Chairman ROSTENKOWSKI. Excuse me.

Mr. PICKLE. I want to ask you a question in response to a question asked earlier about whether the S&L cost should be on budget.

You indicated it should. You also pointed out the cost incurred years ago. We ought to have been considered it then.

That raises a question in my mind. Should we have some kind of budget credit reform that is in our budget process so that we can better estimate the cost of the Federal guarantees.

I raise that question because in the case of GSE, such as Freddie Mac or Sallie Mae or Fannie Mae, shouldn't we be including the potential costs, including the risk that is involved as we go along in our budget consideration?

Mr. VOLCKER. You could evaluate it. The trouble is, it is hard to evaluate these things.

When this savings and loan debacle was building, we knew there was a problem.

We didn't know there was a problem on the scale that now is apparent.

I happen to, in a private capacity, have looked at the Fannie Mae capital situation and reached a conclusion that chances of any loss to the taxpayer in that particular area, given their own plans of raising their capital, are quite remote.

I don't think there is, therefore, any need to put anything in the budget to take care of losses on Fannie Mae.

Mr. PICKLE. We do that in the case of Social Security in some of our programs.

Are you saying we should not put funds in it to guard against a potential risk from GSE?

Mr. VOLCKER. If you had a risky program where you had some way of measuring the risk, I think it would be useful to put it in.

I don't know many programs of that sort. There has long been an argument, and I would agree with this, and it is done, anyway, about how much subsidy is in these programs?

Not just the credit loss; that might be part of it, but how much subsidy is there from cheap financing?

Mr. PICKLE. Are you saying then we should not try to protect against the risk involved?

Mr. VOLCKER. If you knew a program, if you could assess the risk in a program in some reasonable way, I would put it in, yes; but I don't know——

Mr. PICKLE. I hope we can find such a way. Otherwise, there is no protection like an S&L because you don't know that the risk is happening when they are occurring.

You are correct about that.

If we do have these risks in GSE's and they are real, if we can find a way to have a credit reform, I think we ought to approach it.

I would assume you are saying we could if we find a way to do it?

Mr. VOLCKER. If you find a way to do it.

Let me tell you what happens in the opposite direction. The FDIC fund and the FSLIC fund didn't used to be in the budget. They were put in because they were always running surpluses.

They had funds coming in, they never had any significant losses. Somebody said, "Look, let's stick them in the budget and pick up a little revenue."

In hindsight, that was inappropriate. At least those funds should have been considered——

Mr. PICKLE. I find it interesting when you were making a study for Fannie Mae, you did recommend they increase their reserves, and they are doing that and that is good. That is an indication to me they need to take further protection.

Another way would be to establish credit reform in our budget process that if we can find a way, I think we ought to do it.

Mr. DOWNEY [presiding]. Mr. Volcker, let me ask you about the taxation of capital gains.

If I recall, President Kennedy's proposal was conditioned upon a reduction in—one to be paid for by an increase in the other.

It seems to me difficult to make the argument that a capital gains-rated debt is a disincentive to savings and investment.

If we are looking at ways to pay for long-term capital gains, would this be one area that would be appropriate?

Mr. VOLCKER. I don't have any idea what the revenues involved in that are, what the numbers are.

That piece of the Tax Code, which has been there for a long time, never struck me as particularly logical. It should logically be changed.

Mr. DOWNEY. I thank you.

Since there are no other people, there are also no other questions other than the ones that I might have, but I think we have kept you long enough.

Thank you very much.

Mr. Rohatyn, if you would come forward.

We are going to suspend.

I read your testimony. I agree with it completely.

I would be embarrassed to ask you questions for 10 minutes while people were coming so people that were watching it would construe it to be more of a love-in rather than a question-and-answer period.

We will suspend until the chairman has returned.

Mr. ROHATYN. Fine.

[Brief recess.]

Chairman ROSTENKOWSKI. The committee will resume its sitting.

I think everybody knows our next witness. I think everybody knows by his reputation the outstanding citizen we have with us.

It is always a pleasure to have him testify and share his views with us.

As far as I am concerned, it is very difficult to disagree with some of the ideas that Mr. Rohatyn has expressed here.

I have seen no one in all the time that I have served as chairman who is more practical a person with respect to viewing Government and citizens' responsibility than Felix Rohatyn.

I know you had a long journey to get here. I want you to know how much I appreciate the fact that you have flown across the Atlantic to be here.

I just want you to know how much I appreciate it. Thank you very much.

You may proceed.

STATEMENT OF FELIX G. ROHATYN, SENIOR PARTNER, LAZARD FRERES & CO., NEW YORK, N.Y.

Mr. ROHATYN. Thank you, Mr. Chairman.

It is always a pleasure to be here.

I don't really want to read my testimony. You have it.

I think I will just try to quickly summarize at least some of the points that I was trying to make. They deal not only with the S&L bailout, which was really, I thought, the subject, the focus of these hearings and the issue of the debt limit, but really what is the overall economic strategy of this country.

Because I think that is what we were really talking about, and when you look at the rest of the world and you look at, you know, what is going to happen in the year 2000, it seems to me that time is going very rapidly for us.

It is working against us in terms of what the Europeans are doing, what the Japanese are doing.

I think that we are becoming mesmerized with issues that are not the correct issues.

It seems to me the correct economic issue that we have to deal with in this country is how to get interest rates down, how to refinance the mountains of debt that are both in the public and the private sector.

We have to be able to export capital if we are going to remain a world power instead of importing capital all the time.

We have to be independent of the need for foreign capital. That doesn't mean that we shouldn't welcome foreign capital, but we shouldn't be dependent on it.

We have to have strong public and private investment. Private investment in terms of industry, new facilities, research and development.

Public investment in terms of infrastructure, in terms of public education, et cetera.

I don't believe we can do that when our monetary policy is frozen by the budget deficits that are rolling forward every year.

I don't believe we can do that unless we deal with three related issues separately, but in effect connected to each other.

Those are—whether they are off-budget or on-budget is really not particularly relevant because I think what is the only important issue is how much money the U.S. Government has to borrow.

Therefore, to me, Social Security, the S&L bailout, and the remaining budgetary issues are all interconnected, but I do think they require separate treatment.

I think that if this country is going to become an investing country, a great opportunity to do it is to segregate out the Social Security trust funds, make them a real trust fund and take them out of the budget and not use them to mask the budget deficit.

Over the next 10 years, you would accumulate probably over $1 trillion, which could be used to buy U.S. Government securities.

To some extent, you might allow the trust funds to acquire high-rate municipal securities to finance infrastructure.

You would have a trillion dollar pool of investment available to the United States for public purposes.

In terms of the S&Ls, I think it is both economically and morally wrong to borrow money to pay off losses that have already been incurred.

I think that the money has been lost. More money may be lost, or at least to the extent we know, $130 or $150 billion are going to be lost or have been lost.

The notion that we are going to borrow $500 billion over the next 20 or 30 years to pay that off strikes me as grotesque.

I believe the right way to do this and probably the least economically damaging way to do it would be to deal with this over a 3- or 4-year period by putting a flat 5-percent surtax on income taxes and getting this problem behind us.

I wouldn't recommend any such thing unless at the same time you deal with the regulatory and legislative weaknesses in the system, especially Federal deposit insurance, in order to make sure that this doesn't happen again.

I mean the thing that also astounds me somewhat in this super bowl of corruption and ineptness that the S&L have become is the fact that nobody has locked the barn door yet. The Federal deposit insurance system is still sucking in money at very high rates.

Certainly some steps have been taken to limit the investment follies that have been committed by the S&Ls, but I read in the papers that there is pressure on the Congress to loosen the capital requirements on the S&Ls, that there is pressure on the Congress to eliminate RICO from financial crimes, which I think would not be the right thing to do at this point.

I think if we are going to be paying $130 or $150 billion for both economic ills and huge mistakes in judgment and fraud, we ought to have a system that makes sure that it doesn't happen again.

I believe also that a tax to pay off the S&L losses over the next 3 or 4 years would not be economically damaging because it is essentially a simple transfer program from taxpayers to depositors.

I would rather do it with a simple tax than borrowing money and charging the budget with the interest costs over the next 20 to 30 years that will squeeze other programs out of the budget.

At the same time since, I believe, as I said earlier, that the biggest weakness in our economy is the high levels of debt and the needs for continued borrowing, I believe that eliminating that $500 or $130 billion annually that has to be refinanced every year to do this would be highly, highly beneficial.

I believe that if you do this, the rest of the budget will be looking at a deficit of somewhere probably, if you take out Social Security and you take out the S&Ls, you will be left with somewhere around $250 billion. You can then handle this with a combination of cuts in both military and nonmilitary programs, and probably some combination of energy taxes and taxes on Social Security benefits, and over a 5- or 6-year period bring the deficit down to somewhere below $100 billion. This can easily be financed if you have turned Social Security into a real savings pool and if you have eliminated the problems of the S&Ls.

I think, Mr. Chairman, the object of this exercise, which would be to reduce the Government's borrowing requirements by somewhere between $75 to $100 billion a year, if it is done properly and if it has the cooperation of the Fed and the other central banks, should have as its objective and should quite likely achieve the objective of cutting interest rates in half in this country over the next 3, 4 years, which would have a dramatic impact on the ability to refinance our banks and our businesses, would have a huge lift to the securities and financial markets and would enable us to finance those programs that we have to finance both in the public and the private sector.

I think if you look at what is happening in the world today, if you see the European spending $100 billion on rapid rail systems, if you look at the French and the British developing the next generation of supersonic transports, if you look at the Europeans and the Japanese competing for high definition television and you see most of our industries involved, if they are involved at all, are subcontractors and nothing else.

At the same time look at the educational levels of the public school systems in both Europe and Japan as compared to ours.

The conclusion that things aren't as great as they appear here becomes somewhat self-evident.

I think the opportunity facing this country is fabulous. We have a great system, we have a very resilient economy.

We have the collapse of communism staring us in the face and enormous technological progress which enables us to do any number of things, but if we don't take advantage of this opportunity—and this window of opportunity is not going to stay open forever—then I think we are—I am not saying we will be a second-rate power, but we will be a first-rate military power with a rather mediocre social and industrial and financial structure.

That is not what the United States should be and that is not the role that the United States should be playing at the beginning of the 21st century.

The world needs a leader. The only super power capable of doing that, in my judgment, is the United States, but we have to get our house in order if we are going to do that.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Testimony by
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Before
THE U.S. HOUSE OF REPRESENTATIVES
Committee on Ways and Means
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The Summer of 1990 could be called "The Summit Season". We have had the Gorbachev Summit, we are into the "Budget Summit", and we are preparing for the "Economic Summit" in July. Each of these Summits is important in its own right; what is more important is the fact that they are totally interconnected. They all involve the organization of the Post-Cold War world.

It is important to view the process that is presently taking place as similar to the organization of peace after World Wars I. and II. We now have to organize the peace after the Cold War. The organization of peace after World War I. failed partly because of the harshness of the Versailles Treaty and, most importantly because of the failure of the U.S. to assume a leadership role in the post-war world. The organization of peace after World War II succeeded, largely because of continued American involvement and leadership, as well as by the creation of international security structures such as NATO, and economic structures under the Bretton Woods agreements, which secured Western peace and prosperity.

We are now faced with the necessity of organizing peace after the Cold War, as urgently as we did after World War I. and II. There are two major differences with the past and one important similarity. The differences are: First, after the previous wars, the peace was imposed by the victors on the losers; in this case, the peace has to be negotiated between the winners and the losers. This is actually a very healthy thing. Second, the elements of the previous peace settlements were primarily focused on military security and secondarily on political and economic issues. In the present situation, the reverse is true: The primary focus will be political and economic, and the subsidiary issues (although critically important) will be military security. In all three cases, however, it is essential for the U.S. to assume a leadership role.

The U.S., today, is the only superpower with the military and economic power, together with the political stability, that can exercise influence anywhere on the globe; and of all the major powers, it has the most benign tradition in terms of its geopolitical history. However, if the U.S. is to assume the leadership role that it should, we have to deal with urgent domestic problems which have long been neglected. Otherwise, we will have neither the means, nor the reach, to exercise our influence as powerfully as we may have to. It is for that reason that the forthcoming "Budget Summit" may be as important as the Gorbachev Summit and probably more important than the Economic Summit in Houston.

In order to determine what needs to be done domestically to allow us to play such a role, we have to look at the coming decade not so much in order to make predictions (which are likely to be wrong anyway), but at least to make some reasonable assumptions about what will be required of a leading world power in the next ten years. This falls into three major categories: Industrial; financial; and military.

Tomorrow's leading industries will revolve around investment not just in plant and equipment, but in knowledge and technology. They will require national commitments to education as well as to research anddevelopment. They may also require, unless Japan and some European countries change their way of doing business, some variants of industrial policy to maintain a national position in key industries.

On the financial side, it is likely that there will be a world-wide shortage of capital. The political necessity for the development of Eastern Europe and of the Soviet Union, of China and of other parts of the Third World, will require more surplus capital than the developed world is capable of generating. This requirement will include huge investments for environmental clean up and control which are barely surfacing at this time. Tomorrow's superpower will have to generate capital through high savings and productivity rates; the capital will have to be cheap in order to provide a competitive advantage; the capital will have to be available for the superpower to export to other countries.

On the military side, a nuclear deterrent and the ability to project conventional power to defuse regional conflicts or to punish terrorist states will be required.

Germany and Japan will clearly qualify insofar as both industrial and financial power are concerned. The United States, if we continue on our present path, may qualify, in the year 2000, only as a military superpower. That is not good enough.

In order to assume the leadership role which the U.S. must play in the organization of the post-Cold-War Peace, we must be in a position to provide credits and economic assistance in amounts and on terms that are competitive with Germany and Japan. We are not in a position to do so now. We must be in a position to be fully competitive as major manufacturing suppliers to any nation in the world; we are not in that position today. We must be in a position to negotiate reasonable trade relationships with Japan and the Europe of 1992, and we will not be able to do so as long as we are as dependent on foreign capital as we are today.

The Budget Summit should set the path of this Country for the next decade in economic, social and national security terms. Balancing the budget is not an end in itself; it is a means to an end. Balancing the budget will reduce interest rates, reduce our dependence on foreign capital and raise our savings rates. These are all very important benefits. But how we balance the budget is at least as important and the answers, for there are many, depend on what we are trying to achieve. They also depend critically on how we view the proper role of government in an advanced industrial democracy at the end of the 20th Century.

These are complicated questions, but they have to be addressed before we start talking about whether we need to cut $50 billion or $60 billion from the deficit next year; or $500 billion over 5 years; or whether to impose a gasoline tax or a VAT; cut Social Security COLAS or eliminate the B2 bomber. These fundamental questions of national objectives are of such importance to the future of

this Country that they have to be fully debated and understood to generate the political support necessary for such a program. This cannot be done by 20 or 30 congressmen and senators, no matter how sophisticated and well-meaning, locked in a windowless room with the Budget Director and other Administration officials, throwing numbers around like frisbees. The numbers will, in any case, turn out to be wrong, but the objectives have to be agreed upon first.

A public analysis of the existing situation is necessary before remedies are suggested. This should include how we got here, where we are and where we are going under the present set of circumstances. It does not require the assignment of political blame, nor does it require the President to make a public appeal to the Nation. All it requires is a series of Congressional hearings at which the Director of OMB, the Secretary of the Treasury, the Chairman of the Federal Reserve, and head of the CBO would lay out the present budgetary situation. This should include estimates for the next five years not only of deficits, but of the borrowing requirements of the Government and the likely impact on interest rates.

Such a presentation will not cause a financial panic; on the contrary. Disclosure is always more reassuring than uncertainty. Disclosure should also lead to a more educated approach to the problem, beginning with the recognition that the budget debate should be broken up into three separate components: The Social Security system; the S&L crisis; the operating budget. Each of these components should be dealt with differently, and how each of them is treated should be a function of our overall economic objectives. Simultaneously, The Gramm-Rudman law should be amended or dismantled to take that reality into account. Let us look at each of these separately:

1) Social Security - The Social Security system should become what most people think it is, but which it is not: A real Trust Fund, with real money, and a real savings pool for the American economy. It should not be used to mask the budget deficit. It should be removed from the budget and a Trust Fund set up which, over the next decade, would probably build up a national savings pool amounting to over one trillion dollars. These funds should be invested in U.S. Treasury securities with a portion thereof (say 20-25%) eligible for investment in high-grade state and local government bonds, to be used to finance local infrastructure projects. Such a proposal is presently under study by Senator Bob Graham (FLA.) and deserves support.

2) The S&L Crisis - The S&L crisis is a product of the last decade. It is the joint political responsibility of several Administrations and congresses. It is the result of thoughtless deregulation, irresponsible Federal insurance, inept oversight. It is also the result of a level of theft, corruption, greed and stupidity on the part of owners, managers, real estate operators, and junk bond peddlers beyond the human imagination. It is too easy to blame the crisis on the collapse of the real estate market; we have had a collapse in the Northeast real estate market without collapsing thrifts. No, what happened here is that the American taxpayer was defrauded of over $100 billion (and maybe much more) in the greatest network of financial scams ever perpetrated.

We should not compound the felony of what happened by dealing with it irresponsibly. The present losses of the S&L's are estimated at about $100-130 billion; this will change time and time again as interest rates and real estate values fluctuate. They will probably grow larger. But that is no excuse to avoid the basic choices. These are either: To deal with this in a straightforward way, i.e., to impose a tax to pay off the losses; or to borrow money and pay it over the next two or three decades.

Borrowing the money will turn a $130 billion problem into a $500 billion drain (or much more) over the next 20 to 30 years, leaving it to our children to pay off our own stupidity, as well as keeping a drag on the economy by the continued drain on the capital markets. This is an irresponsible approach. Instead, we should impose a 3-4 year surcharge on the income tax, i.e., $25-30 billion per annum, to make up these losses; a 5% temporary increase in tax rates across the board would accomplish this. If the numbers turn out to be better, the surcharge could be extinguished earlier; if they are worse, it would be extended. The tax should be segregated and paid directly into the Resolution Trust Corporation.

At the same time, no matter what the approach, the Deposit Insurance system must be changed. The present system is one of the main culprits for this situation. Federal insurance should be for a lower amount (say $50,000), should not cover more than one account per depositor, and should not allow brokered deposits. Even though the horse is out of the barn, we have still not closed the door.

The S&L bailout is a simple transfer payment program from the taxpayers to the depositors - treating it as such will have no negative economic impact. It is not neutral, however, from a regional point of view. The economic drain from the Northern and the Central part of the U.S. to the Southwest and West will be very real. It will require compensatory action.

Since it is unlikely that either the Congress or the Administration can really face up to this issue politically, a special Presidential Commission, along the lines of the Social Security Commission, should be appointed to deal with both the financing and the regulatory aspect of the S&L's. It is worth considering that there may not be an economic function for S&L's in today's financial markets. A logical candidate to chair such a Commission would be Paul Volcker.

3) The Operating Budget - The operating budget should be brought into rough balance over a 5-year period, once the Social Security Funds have been excluded and the S&L bailout has been put on a self-liquidating basis. The current deficit excluding social security appears to be about $250 billion. It should be reduced to about $50 billion or so over five years.

Military spending will clearly be a significant part of any such program but it has to be done intelligently and related to the changing nature of our military missions and threats. Senator Nunn has been pushing for such a redefinition and it should be part of this process. Reductions of 25% to as much as 50% over 5 years have been put forward by a variety of experts. Significant military spending reductions will clearly be part of any overall budget plan; a saving of $100 billion from present projections by 1995 seems to be a generally accepted assumption. Some other federal programs will have to be reduced or even cut completely, such as agricultural subsidies. Others, however, might have to be increased, such as aid to public education.

Our educational system is superb at the university level; it is collapsing at the primary and secondary education level. In the big cities, if we are to have any chance of bringing millions of young blacks and hispanics into the mainstream of American society and enable them to be productive members of our economy, major changes into the very nature of the schools will have to take place. I am fully aware of the fact that public schools are a state and local government responsibility. But international competitiveness is a national issue; so is the educational level of Americans; so is the basic civil right to a decent

education. There are perfectly valid roles for the Federal Government to play in assisting local public school systems.

Such an involvement could include two areas: decent physical facilities and the application of technology. Insofar as physical facilities are concerned, the ability of the Social Security trust funds to invest in state and local government bonds for infrastructure projects could be a very significant factor in local school construction. We have school buildings in New York City which make our jails look hospitable. In addition, the Federal Government should devise programs, in partnership with private industry, to bring technology to the public school. Public schools may be one of the last places in America where technology has had practically no impact. This technology must be aimed at parents as well as children. The use of computers, television and VCR's as part of the teaching process, beginning in Kindergarten, must be attempted as part of a program to reverse the very negative achievement and dropout rates of our public school systems. A quick look at some of the minimum educational standards being recommended to the EC for 1992, and at the uses of technology in other countries, should convince Americans that, unless we change, we will be falling further and further behind.

Another objective of a long-range budget plan should be a program of general assistance to state and local governments. It is a well known fact that, for the last ten years, federal budget cuts, coupled with a variety of mandates, have dramatically affected our local governments. Service cuts and tax increases of the most regressive types are hurting the national economy by causing localized recessions and turning one city after another into a war zone. And these are war zones where the fight against crime, drugs, AIDS, poverty and homelessness is being lost every day. It does not help the image of America when the foreign press and TV focuses on the decaying quality of life in our major cities. It does not help tourism, one of our major industries, if foreigners only come to the Grand Canyon or to Disney World because they are frightened of New York or Washington or Chicago. And, most importantly, it does not help America to have our Country increasingly polarized by white middle class flight from the Cities, leaving a downward spiral of misery and ignorance behind; it is socially and economically destructive.

As we begin a process aimed at budget balance, a program should be devised which would return funds to State and local governments, solely for the purpose of state and local tax reductions. This would be a stimulus to the local economies while allowing local governments to maintain existing service levels. The plight of local governments, today, cannot be overemphasized and anyone who thinks that this will be limited to a few cities like New York is in for a rude shock. The plight will spread, like a national cancer, all over the Country. A program to return a portion of the military savings to local governments, earmarked for local tax reductions, would provide major economic and social benefits to the whole Nation. By 1993/1994 this could begin to provide significant funds for local tax relief, amounting to $20-25 billion annually. It could also help to offset the unequal regional burden of the S&L bailout.

It is only when issues like these, and many others, are discussed and agreed upon that a rational budget plan can be brought forward. The most important economic issues are not the exact amount of the budget deficit, but the actions taken to deal with it. It is also important to look at the total borrowing requirements of the Federal government and its agencies, as well as of the savings pool that can provide these funds. It is interesting to note that from FY 1986 to FY 1990, the publicly held national debt went up by $900 billion despite the existence of Gramm-Rudman.

If a temporary income tax surcharge is segregated to fund the S&L bailout, the revenue side of a long-range budget plan should consist essentially of energy taxes in addition to fully taxing unearned social security benefits. (There is obviously a large "menu" of other possible measures such as sin taxes, the so-called elimination of the "bubble" in the income tax, etc.). The case for energy taxes is more compelling now than ever. First, we are once again importing more than 50% of our oil from the Middle East; this is the region where the danger of armed conflict seems more likely now than in any other part of the world. Second, it is a major part of our trade deficit. Third, controlling air pollution as well as promoting energy conservation. A combination of oil import fees and gasoline taxes amounting to $30-40 billion per annum would not have a negative impact on the economy, would have a beneficial impact on the environment and would strengthen our economy. In addition, taxing unearned benefits of social security is not an unfair price for beneficiaries to pay in exchange for the full segregation of their funds and the protection of their benefits, including the COLA's. Such a tax would raise about $20 billion by 1992, increasing thereafter.

4) Gramm-Rudman - The Gramm-Rudman law should become obsolete. If these measures were to be enacted into law, there should be far less pressure for the endless loopholes and accounting gimmicks. The main argument for Gramm-Rudman is that it is better than nothing. That is no longer clear.

5) Interest Rates - This program, in summary, would accomplish the following: 1) bring the operating budget into near balance over 5-years with a combination of expenditure cuts combined with an energy tax and taxes on unearned Social Security benefits; 2) turn the Social Security funds into a $1 trillion savings pool; 3) pay off the S&L losses in 3-4 years with an income tax surcharge instead of borrowing for 30 years; and 4) reduce state and local taxes by returning part of the military savings to local governments.

What would be the overall economic impact of this program? The Government's borrowing requirements would be reduced by as much as $80-100 billion annually which would practically eliminate our dependence on foreign capital. The Federal Reserve should be able to run a significantly easier monetary policy, with the objective of cutting the prime rate in half, i.e. say to less than 5% within two years. The reduction in interest rates would cause the financial markets to rise significantly; this would enable overleveraged American companies and banks to refinance themselves at low cost and accelerate investment in new facilities. It would reduce the ultimate cost of the S&L bailout. It would probably strengthen the dollar, despite lower interest rates, because of lower inflation risks. This would translate into reduced costs for the various indexed benefit programs ranging from Social Security to pensions; lower interest rates, alone, could ultimately provide additional budgetary savings on the order of $25 billion annually. It would help local governments to deal with increasingly serious social problems, invest more in infrastructure and bring greater focus to improve public education. Our oil imports would be reduced and conservation encouraged.

The stronger dollar would require greater efforts to be made to reduce our trade deficit. But lower capital costs would give our businesses the incentive to invest; lower inflation would help them with their operating costs. Japan has shown that low interest rates and a hard currency are a winning combination. Low capital costs and high levels of investment should allow for greater business/government cooperation in some areas of great future importance. Western Europe is investing $100 billion in new high-speed

rail systems. Western Europe and Japan are competing for tomorrow's HDTV market. France and England are jointly developing the next generation of supersonic transports. U.S. industry is only a minor subparticipant in any of these areas and that is not good enough. For the U.S. to be a leading participant, we need a solvent government cooperating with strong domestic industries.

Our reduced dependence on foreign capital and the refinancing of our financial institutions should enable our Government to take a tougher stance in trade negotiations without the constant fear of financial reprisal; it should also allow us to play a more important role in the evolution of events in Eastern Europe and the Soviet Union, where aunited Germany is likely to dominate as a result of her economic power. A moratorium on some Eastern European debt,large commercial credits to the Soviet Union, and many more difficult requests are going to be presented to the U.S. and to Western Europe quite soon. Our ability to meet these requests, if we deem them to be in our national interests, will depend heavily on our own economic strength.

The President of the United States is the symbol of our Nation. If he succeeds, the Nation succeeds; if he fails, the Nation fails. President Bush can invest the great political capital of his popularity in leading this Country to the world position we have to assume, no matter how difficult. Speaker Foley, Senate and House leaders such as Senators Mitchell and Dole, Congressman Michel can exercise their own leadership, supporting the President in such a national program.

The collapse of Communism and the end of the Cold War creates an historical opportunity for the West. For the U.S., it creates an opportunity as well as a responsibility. To assume the role of leaders of the West, which no other country can play, we must put our domestic house in order. It cannot be accomplished without well defined long-range objectives and a realistic understanding of our current posture. But the stakes are very high: They involve our standard-of-living at home and our ability to lead the free world as we reach the Year 2000.

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Chairman ROSTENKOWSKI. Mr. Rohatyn, in your dialog, your exchange with other business leaders, with Government leaders, do you find them being somewhat disappointed in us?

I was in Europe about a month ago and visited several countries behind the Iron Curtain. Their Government leaders were asking, "What has happened to you Americans? Where are you? We want you to participate in what we see as a revolution. Yet, for the reputation that you have enjoyed, or that you enjoy, we don't see a movement."

Mr. Mazowiecki, the Prime Minister of Poland, said in a discussion that I had with him, "The Americans come here. They show us their wares and they discuss with us what the future lies for us and then they go home and they think, and then we never see them again."

He further said, "What is all this thinking that you are doing?"

That, to me, suggests that maybe we are looking for the easy markets. Maybe we are not as competitive as we have been in the past. Maybe we are not as hungry.

But certainly, I think that the age of opportunity as far as Eastern Europe, is there for all of us.

I am not just talking about the United States. I am talking about all the Western free world.

I come back to the United States and I recognize what our problems are here.

I mean, in this gigantic deficit that we have, it is just gnawing at us, and gnawing at us, and making us truly move in the direction of a second-rate power.

Tell me how, why has this happened to us? Do you have any idea about why have we gone in this direction?

Mr. ROHATYN. Well, that is a very broad question, Mr. Chairman.

I think, first of all, we had a certain view that kind of the world belonged to us after World War II, and it did.

When Japanese competition, European competition started, we didn't really take it very seriously. We went along with American business and American labor kind of scratching each other's backs and not being terribly concerned with respect to the competitive structure of the world that was going on around us.

Then I think the inflation of the late seventies and the early eighties was very, very—it was very troublesome as far as our economy was concerned. Then we went on this borrowing binge in the eighties and built this enormous national and private debt.

I would put a lot of the blame for our position today on the huge speculation of the eighties and all kinds of financial markets on the propensity to borrow both in the private and public sector, which in the private sector resulted in having a lot of companies that couldn't invest because of interest charges and in the public sector created a budget deficit situation which politically gave everybody the excuse to do nothing.

If there was a requirement for public education, the answer was, "Well, we can't do anything because we have a budget deficit."

There is a requirement for more research and development; there is the same answer.

If you look at the size of our financial institutions and the size of our big companies and compare them to the foreign competitors that they are looking at, they are not in the same league anymore.

Why are the Germans and why are the French and the Italians penetrating Eastern Europe and we are not?

It is because their Governments are behind their banks and their banks are big enough to take the risks and to arrange the financing and the companies are willing to take the long-term view with respect to their earnings.

Also, it is true that they are more comfortable geographically.

They know the situation better, but it makes a huge difference.

If Mr. Kohl says I am going to lend Mr. Gorbachev $3 billion and the German banks provide the credit, the German banks, A, are much bigger than our banks.

Second, the German Government will guarantee them. We neither have the size nor the ability to do these things any more.

Certainly, a lot of our financial institutions are very fragile. A lot of our companies are just not willing and able to take these risks.

If they do, they will get punished in the markets. Their pension funds wouldn't sell, their stocks, et cetera.

You have an issue of financial strength, financial power and now a culture of short-term attitudes with respect to investment and a conviction that the Government can't do anything.

I mean when I came to this country in 1942, I was convinced, A, that America was, and I still believe it is the greatest country in the world, but I also believed that everything was possible here and that everything was possible because there was some kind of relationship between the private sector and Government where if there was a need to do something and the private sector didn't do it, Government would be able to do it.

That no longer is the case, I believe.

I believe that there is in this country today, the absolute conviction that cost cannot do things, should not do things because when it does them, it is inept, and it can't afford to do them because of the deficit.

I think that is a terrible mistake both psychologically and factually.

Chairman ROSTENKOWSKI. Mr. Rangel

Mr. RANGEL. Thank you, Mr. Chairman.

Thank you, Mr. Rohatyn, for not giving up on the Congress and constantly being there when we need you.

I think what you have done to be with us today is appreciated by all of us.

In your response to the Chair, without placing blame as to how we got to where we are, it appears as though borrowing money and being in debt does not cause any political pain to elected officials.

Talking about how you eliminate that debt obviously has been a subject that Republicans and Democrats have tried successfully to stay away from.

It is clear that the President has made a campaign promise not to talk about taxes.

I don't now whether it is a profile in courage to say that he would consider taxes. It is a great opportunity for the Congress and the President to deal realistically with this problem, especially at a time that he enjoys such a high popularity, and for good cause in many areas.

But assuming that you can't really expect your Congress to act—this is July. November is the election. We have an August recess.

The primary thing that is on many Members' minds is getting reelected.

We are having a summit meeting. We don't know what is going to happen there, but a lot of Democrats and Republicans are going to get locked in.

It may be even too late for the President to take a leadership position.

Assuming that we say, well, we got along this far, let's wait until next year and see what we can do with it, what happens to the private sector, the businessmen, the ones that are really paying taxes now that goes to debt servicing, instead of getting a fair return in terms of investment in education for labor market, suffering a deteriorating infrastructure.

Businessmen can see the system is not working as it is, and they have the vision and the economists and advisers to let them know clearly that it is going to get worse.

We knew they were around in 1981. I mean, they were on this hill. They were knocking, they were knocking in with jets. They let us know that we had to give Reagan a chance.

Where is the private sector?

Not to say it is not our responsibility, but, you know, our chairman came up with a package that no one associated themselves with it.

My senior Senator from New York, he came up with a package.

The President comes up with nothing.

None of us are under pressure back home from the private sector that I know of to do the right thing.

You talked at conferences, at the meetings. I know they are complaining, but what are they doing about it? Are they prepared to say that they are going to take us to the mat and support us when we are right and to hurt us when we are wrong?

Is there an economic roundtable that says, "Enough already; thank you," and the Presidents are going to have to do something about this?

Mr. ROHATYN. I can't speak for the entire business community obviously, but in terms of the members of the roundtable whom I know, in terms of the boards that I sit on, I would think there would be very strong support from the business community for a strong deficit reduction that included reasonable taxes.

I think the business community, you know, looks at what experts call political realities and kinds of throws up its hands and says, "It can't be done," but I believe that if the correct signals were given and a strong plan were put forward, either as a result of the summit, of the budget summit or by the President himself——

Mr. RANGEL. You say they are waiting for us to make their first move?

Mr. ROHATYN. As far as I recall it, I think the business roundtable has indicated pretty strong support for deficit reduction, including some types of taxation.

It is also very difficult to get them together on any one thing.

You have different companies with different interests.

Mr. RANGEL. Thank you.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Downey.

Mr. DOWNEY. Thank you, Mr. Chairman.

Mr. Rohatyn, I want to just add my voice to that of my chairman and my senior colleague from New York and welcome you to the committee.

I have had, along with thousands of others in our country, the privilege of reading your fine works in the New York review of books from time to time in New York papers.

If Mark Twain's adage is correct that if two people agree, one is doing all the thinking, I am delighted to finally meet the person who is doing the thinking for both of us.

I want to ask you about the top rate and then I want to ask you about some of the regional disparities of wealth and transfers of wealth which I see underlying part of the S&L problem.

First is the top rate.

I happen to think that 28 percent top rate is too low and that given the depressing economic infrastructure and needs of our

Nation, it has to be raised so that we can in part pay for some of these things and get on with the business of putting our fiscal house in order.

I would like you to respond to that.

Second, I would like you to respond to the fact that as Professor Hill and Mr. Guarini has more information on this, and it is my hope he will talk to you a little bit about this, had written an article called, "The S&L Bailouts," some States gain, many more lose."

The impact of the transfer of wealth from major States where we don't have failed S&Ls to States that have had large failures, is that something that we should be concerned about?

Do you see any real economic impact?

Mr. ROHATYN. Mr. Downey, to take your second question first, I think that is something that is very real.

I couldn't quantify it, but somebody should do some work on looking at the impact.

What you have really had with the S&Ls is a double transfer of wealth.

You had the initial transfer when in the late seventies and early eighties Federal deposit insurance was increased and the S&Ls started succeeding in deposits from all over the country to those parts of the country that are now facing the problems, but the money went down there and it was spent.

It was spent on real estate. It was spent on junk bonds. It was spent on all kinds of development.

The money is down there.

Now, you have a second round of wealth transfer. Since a lot of the money has been lost, the money to make up the losses is flowing back down there again, in addition to sales of assets that are now taking place.

And both, with respect to the S&Ls and in terms of the FDIC bailing out a group of Texas banks, I believe that that is responsible for a great deal of pickup in economic activity in the Southwest and Western part of the United States.

Now, clearly it was in the national interest to do that. On the other hand, I think one has to recognize that the Northern part of the country, or the Northeast and Midwestern part of the country, those parts of the country is where we have not had these kind of problems.

We are, in effect, subsidizing. We are subsidizing these other regions.

It is an expensive exercise especially since our own economies are pretty slow.

At some point, somebody either in the Congress or outside the Congress ought to do some really sophisticated work in terms of looking at the impact of these regional flows which have, as I aid, happened twice or maybe three times now.

Insofar as your question about income tax rates are concerned, most Western developed countries have higher income tax rates than the United States.

They also have, especially the Europeans, the Western Europeans, probably more effective safety nets, social safety nets, and are more respecting of Government to provide support.

At the same time, I believe that—so I think that some modest increase in the income taxes is not at all unthinkable as far as I am concerned.

As I said earlier, I would be inclined to use some kind of a surtax on income taxes to fund the S&L bailout.

I would use other taxes, especially energy taxes, gasoline taxes, that are four times our level in the rest of the world to deal with some of our other budgetary problems.

I don't think they would hurt the economy at all. I think they would bring down interest rates which would more than make up for any economic dragon.

Mr. DOWNEY. Is it fair, Congressman Russo first gave me this idea. Let me label it the Russo theory. It is a corollary to other theories.

Historically, we learned in economics that you added 3 percentage points to whatever the underlying inflation rate was to give you some working definition of what you expected interest rates to be.

If we do that today, assuming that inflation is at 3 percent, that additional 3 percent would give us what should be real interest rates of 6.

I understand that interest rates in our country are subject now to international pressure, so I am not in any way attempting to be simplistic.

When I explain to people the need for us to bring down interest rates, I say they are already paying a tax. They pay this tax if they try to buy a home or a car or if they are using their credit card.

These interest rates above 6 or 5 percent are reflected because our borrowing demands are so great.

Is that a reasonable explanation to people?

Mr. ROHATYN. I think it is. I think it is, which is why when you look at the impact of borrowing $130 billion or $150 billion for 30 years to bail out the S&Ls, you have to add $15 to $20 billion a year of interest costs that you are subjecting the budget to and which is going to be paid for by everybody in this country in addition to raising interest rates overall by increasing the borrowing requirements of the Government.

I think that is absolutely correct.

Mr. DOWNEY. Thank you.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Chairman.

It is again a pleasure to see you, and it is very refreshing to have your frank remarks. We seek your advice.

You have been very helpful in the past and we appreciate you being here today.

Mr. ROHATYN. I am not sure I can stand much more than this, but I am very grateful.

Mr. GUARINI. We appreciate your helpfulness.

The surtax which you mentioned of 5 percent will probably give you about $22 billion.

Of course, it hits corporations and individuals across the board.

As I understand, it would be progressive. It won't dislocate any region.

It would not target any industry and it would sunset, et cetera.

Then you went on to say raise the top rate and perhaps a gasoline tax.

Could the economy—could recessionary pressures that we have take all these kind of taxes at one time?

Where would the breaking point be? How far do you think we could go without having downward recessionary pressures?

Mr. ROHATYN. That is a little bit like modern art. It is kind of in the eye of the beholder.

I would think, to begin with, that an income tax surcharge with respect to the S&L bailout would be economically neutral.

There you are transferring money from the taxpayer to the depositor.

The money gets cycled back into the economy.

It would be, I think, the one tax that would have no economic drag.

At the same time by reducing the borrowing requirement of the Government, it would help bring interest rates down.

I believe energy taxes, especially gasoline taxes, possibly oil import fees, because you have to remember that we could have a blowup in the Middle East any day now. We are importing now more than 50 percent of our oil again.

We have become as dependent on foreign oil as we are on foreign capital at this point, which is not a very good thing.

Some combination of oil import fees and gas taxes, I believe would have no negative impact on the economy, especially if it were offset by an aggressive interest rate reduction program by the Fed together with the central Banks of Europe and Japan.

In addition, I believe that the upward impact on the financial markets of interest rate reduction would more than make up for any drag in the economy, especially if, in addition, you segregated out Social Security and turned it into a huge investment pool that was able again to aggressively participate in this interest rate reduction program.

Mr. GUARINI. Should the Federal Reserve link interest rate reduction, with the taxes that we would pass? Would that be a reason why——

Mr. ROHATYN. I know that my friend, Alan Greenspan, who is a very careful man, that the Feds should make it quite clear that if a major deficit reduction package were to come forward, including taxes that they would aggressively push interest rates down.

Mr. GUARINI. New York has a lot of local taxes, State taxes that have been raised. These would be compounded on top of the kind of Federal taxes we are talking about here.

Do you see the recession becoming deeper as a result of the need for local and State/Federal taxes all at the same time?

Mr. ROHATYN. Again, that is a risk we have—as you correctly point out, we have just raised taxes in New York by about $800 million.

The State of New York has raised taxes a couple of times this year by probably a couple of billions.

I still think that—and we are in the grips of a recession. Certainly New York is in a recession. New York State isn't very far behind, but I do think that the stimulus of interest rate reduction

to the overall economy would more than make up for any contraction in the budget program.

I would be willing to take the risk. I think the really unacceptable risk that we are running here is in the credit structure of the country, both private and public.

If, because of what is happening in Eastern Europe or the Soviet Union or the Japanese beginning to see to their own needs and the flow of worldwide savings slowing down in this country, you could have an upward movement in interest rates that would be very destructive to both the private and the public sector.

Mr. GUARINI. If there is a transfer of wealth from one sector of the country to the other, should there be cyclical funds or some kind of evening off or leveling off so one region doesn't fall in more of a recession than it should?

Mr. ROHATYN. I think if you can really come up with a credible 4- or 5-year credit reduction program that ultimately provides the means to do some of the things this country should be doing, that some kind of a program of moneys flowing back to State and local Governments to be used for local tax reduction could be geared to this kind of a regional impact to some extent.

Mr. GUARINI. Like revenue sharing should be brought back?

Mr. ROHATYN. I know revenue sharing is a dirty word here. I would use some——

Mr. GUARINI. Euphemism.

Mr. ROHATYN. Euphemism, but some type of program that would flow money back to State and local Governments, but solely geared to local tax reduction in order to even out some of these problems is something worth considering when we have the means to do it.

Mr. GUARINI. I yield to Mrs. Kennelly.

Mrs. KENNELLY. Yes.

Mr. Rohatyn, we thank you very much.

I sat this morning and listened to our representative of our Treasury tell us that he could not really forecast any numbers, give us any definite figures.

I then spoke to a very esteemed Member of Congress, Mr. John Dingell, who was involved in a bailout.

Of course, you, yourself was very involved in the New York bailout when they had trouble.

Do you think it is fair for the administration to expect us to continue allowing further funding without giving us definitive numbers or should our responsibility be to demand better numbers than we have received so far?

Mr. ROHATYN. Well, your numbers, the numbers you are getting keep changing all the time, and I am sure that that is very frustrating.

On the other hand, I am not sure that they have numbers that are any better. I mean, the issue of valuing the real estate that these savings and loans have, I mean, those are big, big numbers, and any swing in those numbers will make a big difference in the deficit.

The values in their jump on portfolios are going to be variables. So I am not sure how practical it is to have accurate forecasts.

On the other hand, you should be kept up to date as to what the numbers are on a regular basis. And you should also, in my judg-

ment, not agree to fund these deficits until changes have been made in the way the structure works.

Mrs. KENNELLY. That is what I was going to get to next. You said the door to the barn has not been closed. We were told this morning there was a precedent in the Federal budget for providing indefinite authority to fund mandatory activities.

I really feel that that door should be closed. Can you suggest any way for us to close the door so this flow doesn't continue indefinitely?

Mr. ROHATYN. Well, the day you change the legislation, the deals with Federal deposit insurance, and you bring it down from $100,000 to $50,000, and you limit it to one guarantee per depositor, and you eliminate brokered accounts and things of that kind, you are going to be locking a lot of doors.

And if you keep, you keep on strengthening capital requirements and prohibiting investments of low investment grade securities, all of these things are things that you can do.

And I think until you do them, this money is going to be coming in one end, and it's going to go out the other end.

I mean sure, some of these things have been improved, and investment practices have been curtailed. But you still have a fundamental issue here, which is guaranteeing Federal insurance to anybody running one of these things.

Mrs. KENNELLY. I am intrigued with your idea about paying it off now rather than passing it onto our children and our grandchildren. Have you run numbers, or is this just a theoretical suggestion that you gave to the press?

Mr. ROHATYN. Well, I think 5 percent on the income tax across the board would be somewhere, I think, around $25 billion. And if you have $130 to $150 billion loss over a 3-, 4- or 5-year period, you would have it behind you.

Instead of dragging $15 to $20 billion a year in interest costs on the budget for the next 30 or 40 years, having your kids pay it off, squeezing out programs that are very, very needy, for no economic justification otherwise.

I was always taught that you could only justify borrowing for assets that are a useful life. I can think of nothing that fits the category less than money that has already been lost in the savings and loans.

Mrs. KENNELLY. Thank you, sir. I thought your speech at the National Press Club was the best one I have read this season, and I hope you don't mind if I use it in my campaigning or paraphrase it.

Mr. ROHATYN. Thank you very much.

Mrs. KENNELLY. Thank you for your testimony.

Mr. MOODY. Thank you again, and thanks, Mr. Chairman. We won't have much more time if a vote is underway.

I agree with everything you have said and it just makes me all the more outraged that the administration was able to get away with the savings and loan package that they supported last year on the pretext that the market would be shuddering if we put it on budget and therefore had to rewrite Gramm-Rudman.

We are now in exactly that fix. We are going to have to rewrite Gramm-Rudman drastically because the numbers are so overwhelming.

The market wasn't fooled.

Mr. ROHATYN. No, it certainly is not.

Mr. MOODY. I thought that was a very facetious argument. Someone I respect very much came here and made that argument sitting in that chair, Secretary Brady.

Mr. ROHATYN. What shakes up the market is every 6 months finding out that their loss has grown by $40 to $50 billion.

Mr. MOODY. Right.

You said what we really need is a credible 4- to 5-year deficit reduction program. That is what Gramm-Rudman was supposed to be, remember?

But we just invented a whole series of ways of getting through and around and under the targets. If the President of this country is not willing to take the lead on this issue, how in the heck do we get a 4- to 5-year credible, underline the word "credible," deficit reduction program?

Mr. ROHATYN. Well, I think that the President is very popular. The President has a lot going for him, and I think if the President and the congressional leadership were to come out with a—with a long-term program, I think it would have enormous support. I think the markets would react, the financial markets would react extraordinarily favorably.

And conversely, if this agreement weren't kept, that you would have an unraveling in the financial market and in the dollar that would be more compelling than anything Gramm-Rudman is doing for you at this point.

Mr. MOODY. Right. So it would take 4 or 5 years of tough political bullet biting.

Mr. ROHATYN. I think that is probably right, Congressman.

Mr. MOODY. I would like to discuss your earlier statement regarding sticking our kids, grandkids with the debt.

We are really taking the money out now in terms of resources. We are financing the deficit by pushing money into things other than productive investment.

We are robbing our kids in a somewhat different way than is normally thought of, and since there will be less GNP, 12, 14, or 18 years from now, because we haven't invested capital now.

Mr. ROHATYN. I think that is right. I think that when you borrow money to pay for nonproductive assets, then you are impoverishing the whole economy.

Mr. MOODY. Right.

Mr. ROHATYN. And as I said earlier, I can think of nothing less productive.

Mr. MOODY. So it really isn't the interest that they will be paying. It's also the fact that the whole society will have less infrastructure, so there is really a double hit instead of just one.

Mr. ROHATYN. That is correct.

Mr. MOODY. Thank you.

Mr. PEASE. Thank you, Mr. Rohatyn. You have heard this before this afternoon, but let me repeat it again. It always is a pleasure to have you come before this committee.

Mr. ROHATYN. Always a pleasure to hear nice things, Mr. Pease.

Mr. PEASE. Well, we very much appreciate the kind of straight talk for which you have a well deserved reputation.

We were asked by the Treasury this morning to increase the debt ceiling over the next 3 years by $916 billion, and we were told that that does not take into account any deficit reduction efforts that are being pursued in the Senate.

We read in the press that the summiteers are looking at $50 to $55 billion as a package of revenue increases and spending cuts, and at least some economists are telling them that they shouldn't be spending, or trying to take any more of that out of the economy.

Now, if we were to do $55 billion this year and another $55 billion next year, and another $55 billion the next year, which would be a big assumption. And that would total about $330 billion in the next year, and yet we have a $916 billion increase to the national debt projected. So it would still be $630 billion or so. Is that a viable situation?

Mr. ROHATYN. Well, I don't know, Mr. Pease, where that $900 billion number came from. But if that number is correct, then clearly there is very little end in sight in terms of the growth of the national debt and the inability to get out from under a situation that is going to get progressively more serious.

I know that the national debt, or the debt I believe that is held by the public grew by almost $1 trillion in the years, I think, 1986 to 1990, despite Gramm-Rudman.

Mr. PEASE. Yes.

Mr. ROHATYN. And that, to me, is really, as I said, the big issue. The issue is not to me whether you increase marginal tax rates by 2 or 3 percent, but the issue is whether the national debt grows by $1 trillion every 3 or 4 years, which is unsustainable.

Mr. PEASE. Part of that $916 billion is money the Treasury owes to the Social Security trust fund. Does that make any difference? Does that make it any easier?

Mr. ROHATYN. Well, that makes it easier in terms of the pressure on the financial markets, because that money just gets recycled.

But ultimately it's an increase in debt, and that is why I believe that one should really cut through a lot of this by taking the Social Security trust funds out of the budget, looking at real numbers.

Now, you have, you would have the trust funds out of the budget and treat them as an investment pool. As I said earlier, I believe you should deal with the social—with the savings and loans separately, with a one-shot surtax. And then you have a true budget, what is left of it, and since you have a very large investment pool to finance from, I believe that you can be somewhat more relaxed with respect to how quickly and to what extent you reduce that remaining deficit.

Mr. PEASE. Well, the $916 billion that they project is an increase in the projected debt, national debt over the next 3 years, so whether Social Security is on budget or off budget, and whether the trust funds are on or off, and whether the savings and loan bailout is on or off, the bottom line is that Treasury expects to have to borrow that kind of money over the next——

Mr. ROHATYN. It's kind of a staggering number.

Mr. PEASE. It certainly is a staggering number. And if you can assume that number for a moment, and it's in their testimony, and look at the deficit reduction effort this year, do you think that $50 to $55 billion as a deficit reduction target for this year and repeat-

ed again next year and the year after is about the right number, or do you think we could increase that number, cut the deficit down more without risk to the economy?

Mr. ROHATYN. Well, as I said earlier, I am less—I would be willing to take bigger risks with deficit reduction if it were combined with really sharp interest rate reduction actions by the central banks.

Mr. PEASE. By the what?

Mr. ROHATYN. By not only the Fed, but the central banks, both in Europe and Japan, because I think you would get, you would get enough of a lift as a result of interest on really significant interest rate reduction, and at the same time, you get an additional reduction in the deficit because of the fact that interest costs are such a high part of the budget at this point.

And I think you could go beyond that. If that $900 billion is a real figure, if you are really increasing the national debt by almost $1 trillion over the next 3 years, then it seems to me you have got to do some serious thinking about going somewhat further with reducing the borrowing requirements of the Government, which are the ball game as far as I am concerned.

Mr. PEASE. Surely.

You were saying that you thought interest rates could be cut in half. Does that mean that if T-bills are going now for a little under 8 percent, that they would be going for a little under 4 percent for your scenario?

Mr. ROHATYN. What I said was that I believe that as part of a program where Social Security would be treated as an investment pool, a huge investment pool, where the savings and loans were funded with a surtax, and where the rest of the budget was brought to somewhere between $50 and a $100 billion of balance over a 3-, 4-, 5-year period with a credible program, that as part of such a program, I believe that interest rates in this country might be cut in half over a 3- or 4-year period, with, as I said, the cooperation of the central banks, both in this country and abroad.

Now, maybe that is overambitious, but I do believe that you could have major interest rate reduction and that it would be a necessity.

Mr. PEASE. Well, if we saw the requirement to borrow a lot of money, billions of dollars, even under the best scenario, how could we attract that money if we attract part of it from overseas, how could we attract the investment in our Treasury obligations with a 4- or 5-percent rate?

Would that have to assume that the central banks of every other country, developed country would manage to push their interest rates down that low as well?

Mr. ROHATYN. No. I think what would happen, Mr. Pease, is that if it were clear to the rest of the world that we had our fiscal problems under control and that over some reasonable period of time the borrowing requirements of the U.S. Government would peak and start going down, I think our currency would strengthen, and I think the money would flow into this country, with the expectation that the securities market would be strong, that the bond and stock markets would be strong.

The Japanese had a policy of over the last few years actually the Japanese had lower interest rates and a hard yen, and they had no problems with respect to currency to capital flows.

So I believe that this country should have a policy or sho .d at least attempt to have a policy of low interest rates and a strong currency.

I recognize that when you have a strong currency, you have to fight a little harder to be competitive, but capital costs are, I think, a bigger factor in competitiveness now than labor costs.

So I would be willing to go for that.

Mr. PEASE. Well, the Japanese did not have to import their capital. They were getting it out of their own people.

Mr. ROHATYN. That is right. There is nothing that says that we cannot do the same thing.

Mr. PEASE. What do you think the orders are of getting this kind of agreement, this 5-year program, and not running into a recession over the next 5 years, and if we did run into a recession, how badly would it exacerbate our problems?

Mr. ROHATYN. Well, I think I would put it to you this way: What is the bigger risk of running into a recession when you are adding $1 trillion to the national debt every 3, 4 years, and when your banks and private sector companies are burdened with very high levels of debt?

And I think at that point, to me a recession is an unacceptable risk, as opposed to the risk of a recession, if you have taken strong deficit reduction action and you are dealing with a somewhat more benign financial climate.

I mean, I think that you are in a situation where you cannot avoid risk, because our economy is at risk, and the capital structure of the U.S. economy rather weak.

But the issue is not, is there risk on one side and no risk on the other, but what is the relative risk?

Mr. PEASE. I understand that, and I agree with you entirely. I am not at all suggesting we should not try the path that you are suggesting. What I am trying to do is figure out what the changes are that even that path will lead to failure.

Mr. ROHATYN. The longer you wait, the higher the risk, both of recession and of some kind of real shakeout in the financial markets.

Mr. PEASE. If I might turn to something specific, part of the reason we got into this savings and loan crisis was the deposit insurance situation.

Would you have any comment on proposals floating around to limit the amount of deposit insurance, the dollar amount, and/or limit the $100,000 to one deposit per person, or one deposit per family rather than a rather unlimited exposure that the Government now has?

Mr. ROHATYN. I would do both, Mr. Pease. I would reduce the amount. I would limit it to one per depositor or per family, and I would exclude brokered accounts, brokered deposits from the Federal insurance.

Mr. PEASE. Do you think we could do that without causing a lot of savings and loans and banks to collapse, because of deposits being taken out of those institutions?

Mr. ROHATYN. Well, you would have to continue protecting the existing deposits on the existing basis, but respectively at least at some point you have got to turn off the spigot.

Thank you. So you couldn't retroactively reduce the insurance, but you could certainly do it prospectively.

Mr. PEASE. OK. Thank you very much.

Mr. MATSUI [presiding]. Thank you, Mr. Pease.

Mr. Rohatyn, I also would like, as many other Members before me have said to thank you for your testimony and the fact that you have always given us very, very excellent ideas over the years before our committee.

I would like to ask you just very briefly about a couple areas. On the capital gains issue, you were talking about the cost of capital. According to Joint Tax Committee estimates over a 5-year period, the President's proposal will cost approximately $11 billion, with the larger revenue loss in the last 3 years.

At the same time, Mr. Volcker before you testified that there would be some benefit to the economy to have such a differential because of the cost of the capital problem at this time.

Do you have any additional thoughts on that particular matter?

Mr. ROHATYN. Mr. Matsui, I am not a great believer that reducing capital gains rates would have any great stimulus to the economy or really reduce the cost of capital.

I would be, if you were inclined to do something on capital gains, I would be more inclined to look at a schedule that goes up, say, to 50 percent on short swing gains of, say, holdings under a year and maybe go all the way down to zero for holdings of 10 years or more.

And I don't know what the number—I mean, I am just really philosophically looking at this issue. I would be more inclined to go up on the rate for short swing profits than to put in a stock transfer tax, for instance, which I think would drive some of the securities markets aboard and which would discourage short swing trading and create some revenues.

And I would go, I would go pretty far down for really long-term holdings.

Mr. MATSUI. Well, I appreciate your comment there, because there is no reason that we need to stick to a 28- or 33-percent rate.

Mr. ROHATYN. No, none.

Mr. MATSUI. We could go above the cost of wages.

Mr. ROHATYN. That is right.

Mr. MATSUI. I appreciate that.

Let me move over to the Social Security issue. I think we have a real problem there. In 1983, nobody really gave the surplus issue a lot of thought. Now, assuming that we get our deficit under control in the next 5, 6, or 7 years, the surplus then becomes an issue, because then we start generating a surplus, and we cannot just have that money go out, be used to buy stock in General Motors or Chrysler or IBM, at least I cannot imagine the public supporting Government funds used to purchase stock in private companies.

That means essentially it would be used for public works or some kind of public purpose. And I have been working with Senator Graham on trying to work through all this.

Mr. ROHATYN. I think that bill that you and Senator Gramm are working on is actually something that I support very strongly.

Mr. MATSUI. Well, I appreciate that.

One of our problems, and we are stymied about this, is the fact that if you do use it for public purposes, you then reduce income to the Social Security trust fund, since when you lend the money to the States or local governments, they will pay a lower yield.

Mr. ROHATYN. Because of the tax free nature of the investment?

Mr. MATSUI. Yes.

Mr. ROHATYN. You see, to me, first of all, the worrying about a huge surplus in the year 2000 is not exactly my first priority at this point.

Second, I do believe that the impact of having that kind of a savings pool is just, would be gigantic if the savings pool can be maintained.

And I think on the issue of investing in State and local government bonds, for instance, and equalizing the loss on tax free interest, you could work—I think there is some provision in the bill that I saw that tries to do——

Mr. MATSUI. You could transfer money into the trust fund, right?

Mr. ROHATYN. You could do that. And I do believe that if you did that, if you segregated Social Security funds and really protected the recipients with respect to some of these funds, the notion of taxing benefits for people over certain levels of income, it seems to me is rather equitable.

And I believe that—again, you know, you are very flattering and very nice to me with respect to my testimony, which is consistently impractical politically, and unfolded nationally, but I do believe some of these things could be looked at.

Chairman ROSTENKOWSKI. You know, Felix, I am practical. We have become a Nation of perception. When we cured the insolvency of Social Security in 1983, everybody thought it was the end of the world.

And so we delayed the Social Security COLA for about 6 months, and it wasn't the end of the world.

We corrected what was wrong, and now we have the surplus. But for Members of the Congress, as well, it is perception, it's that if they vote for something that is going to in the long run to cure the problem, they are afraid to do it.

I have a great apprehension about the way the press reports things as well. You know, I think that naturally the medicine is always a little bitter, but the cure is what we are looking for.

And in this country, nobody wants to take the medicine. They want the other guy to take the medicine to cure the illness, and it's just not going to happen.

And, you know, we create what is known as the Gramm-Rudman-Hollings sequestration procedure, and then we are afraid to go into sequestration. But we create this automatic pilot to make us do our job.

And, you know, after you have been here for a little while, you get a little irritated with that. You know, if we did our job, we wouldn't have to worry about Gramm-Rudman-Hollings.

If we raised revenues on a pay-as-you-go plan, we wouldn't have to worry about deficits and becoming less competitive in the world. And that is what the deficit is doing to us.

It's an incrementally growing problem that says well, we cannot afford this, or we have to wait until somebody buys our debt in order for us to keep interest rates lower.

And we have just learned, you know, to live the good life, and we have got to make an adjustment.

And I still say that once people accept their responsibility and do some suffering, in the long run, they feel a little better for it.

I think the education of our children is very important to us. Higher education, sure, children are still coming to this country to be educated in our colleges and universities from all over the world. But those children who received their primary and secondary education elsewhere are coming prepared to go to work. I mean, they are the engineers of tomorrow and our own kids in lower education or in elementary education aren't getting what, in my opinion, they are not going to be equipped to be competitive in the future unless we work to improve our own early education programs.

And that is all because we pay this third ingredient in our expenditures, and that is the interest on the debt, and nobody wants to—nobody seems to want to say, well, then, if we can cure that evil, all the rest of the things will fall in place.

You know, I have been going around the country telling it the way it is. I don't get big ovations, but what really surprises me is the audience and the audience participation and question and answer session. They say to me, "Well, you know, at least you tell it the way it is."

What scares me about that statement is that they don't believe us. They don't believe their Government. People don't believe their Government. And I think that is the biggest problem that we have right now.

But, you know, I go into the summit optimistic as hell, but when we start talking specifics, that optimism just dwindles because I know as well as anybody in the summit, the 21 of us that sit around that table, as soon as we get outside and say, well, I am sorry, there is going to be an increase in revenues here, and an increase in taxes there, they say, oh, I am not going to support that.

Where do we go from here? We go to a sequestration, in the amount of $100 billion. And if our economy cannot afford that, and if we do it, we are going to go into a recession.

Now, what the summit will do, in my opinion, is write an alternative to sequestration, and the membership in this Congress will have to make a decision as to whether or not they want sequestration, or they want the alternative.

The alternative isn't going to be less painful. You know, you tax for a dime, you tax for the dollar, you still get the same grief.

And I just think that there is an opportunity in the next 5 years to make the correction, and George Bush disappoints me when he doesn't use his popularity to lead the country because I know he has got the ability.

But sometimes you just cannot be popular all the time. Sometimes you have to meet your responsibilities. You know, I guess I can mirror everybody's feelings here about the way we view the testimony that you consistently give. I don't think it's at all impractical.

I think you are right on the button. If we listen to you, and if we go get the votes to endorse some of the practical resolutions that you bring here, I think the country would be better off.

Thank you very much for joining us.

Mr. ROHATYN. Thank you, Mr. Chairman.

It's always a pleasure.

[Whereupon, at 3:45 p.m., the hearing was adjourned.]

[A submission for the record follows:]

HENRY GEORGE FOUNDATION OF AMERICA
2000 Century Plaza (238)
Columbia, MD 21044
(301) 740-1177

THE PROBLEM - The government needs the money. It is too late now for Congress to do anything but raise the limit on the public debt. But action could now be taken to reduce the debt in the future. What is needed is a tax which promotes economic growth, not burdens it; this tax should also be in accord with ability-to-pay.

THE PROPOSAL - The Federal Government should levy a special Debt Service Tax on each state equivalent to $100 per capita, with the proviso that the states are to raise the revenue for this special tax by an impost only on land value assessments. Land currently used for farming is to get an assessment reduction of $500 per acre.

Congress has levied a tax very similar to this in 1798, 1813 and 1861 (raising $20 million in the latter year). It has ample constitutional authority to do this again, and the present debt crisis makes it imperative to do so.

THE ADVANTAGES - (1) A tax on land values requires land to be used efficiently because an inefficient improvement would not generate enough income to pay a reasonable profit on the improvement plus the higher land value tax besides; it will actually increase (not decrease) the amount of land available on the marketplace; the efficient use of land will spur economic growth. (2) Such a tax will preserve the clean-and-green countryside from premature growth. (3) Since land ownership is more concentrated than income ownership, a tax on land values will be very much in accord with ability-to-pay. (4) The Federal Debt can be reduced thereby.

Contact us for substantiation of all the above statements. We have done much research on this proposal.

Steven B. Cord
President

August 1988

Incentive Taxation

Sales Tax: Regressive and Punitive

"The richest man in America, billionaire Samuel Walton, has to pay the same amount of sales tax on the shampoo he buys at one of the Walmart stores he owns as does the poorest person in the land.

"Sales taxes are a good deal, in fact they are a great deal, for Mr. Walton and his brethren on the Forbes Magazine list of America's super-rich. But for the vast majority of Americans, sales taxes are another story altogether.

"The nickels and dimes add up. And when they do they take a greater chunk out of the pockets of middle-income families and the poor than they do of the bankrolls of the rich."

These strong words are extracted from a study of the sales tax recently published by the Center for Tax Justice, Washington, D.C. And they have the hard facts to back up their words:

• Families living below the poverty line shell out five times as much income for state sales and excise taxes as do the richest families in the country. That's REGRESSIVE! See table below.

• The sales tax is regressive even under the best of circumstances. New Mexico has the least regressive sales tax, but even there the poor pay a 50% greater share of their incomes in taxes than the richest citizens in the state.

Even the model sales tax crafted by the CTJ takes 2.7% from the income of the poorest fifth of American families and 1.6% from the richest one percent of all families whose incomes average more than $600,000 a year).

In order to make the sales tax more progressive, rebates to the poor can be offered, but they don't help much, and in addition the rebates are difficult to administer.

• A federal sales tax (or "value-added tax" as advocated by some conservatives) would also be regressive, taking 3 ½ to 5 times as high a share of the income of the poor as of the rich.

• Utility taxes are particularly regressive, since gas, electric, sewer and water charges constitute a higher-than-average percentage of the income of the poor. Gasoline taxes are also regressive, but they can be justified insofar as their revenue is earmarked for road building and repair, also traffic control; they would then be charges for services rendered; likewise for utility taxes earmarked for the costs of utility regulation.

LVT

Now as all good readers of this publication full well know, the tax on land values has great advantages over the sales tax:

First, it is the most ability-to-pay tax there is, since land values are more unequally distributed than are retail purchases. The tax also collects unearned income, since the income from land represents pure exploitation; sales taxes, in contrast, are levied on earned incomes.

Second, the sales tax inhibits retail exchanges and therefore inhibits production (thus also jobs and income). By contrast, the land value tax spurs efficient land use; thus, even if the revenue from it were lost, it would nevertheless spur economic production (jobs and income as well).

Conclusion

Let us conclude with a quotation from the CTJ study:

"Can you imagine the political firestorm that state legislators would face if they devised a tax that explicitly took four or five times as great a share of the incomes of poor families as from the rich? The most conservative editorial writers would decry such a tax as cruel, unfair and dastardly.

Advocates for low-income people would hold protest

State & Local Sales Tax Burdens on Families of Four in 1987

QUINTILE:	I	II	III	IV	V,15%	Top 5%	Top 0.7%	Top .7%/I	Top .7%/III
Pennsylvania	2.8%	2.3%	2.0%	1.9%	1.7%	1.2%	0.9%	31%	43%
U.S. Average	3.3%	2.7%	2.3%	2.1%	2.0%	1.4%	1.0%	30%	42%

marches. Even the lobbyists for the rich would be hard-pressed to defend such a scheme.

"Yet when all the nickels and dimes are added up, that in fact is exactly what state sales and excise taxes do."

"So where are the howls of protest?"

INCENTIVE TAXATION

CSE

This bulletin is published by the Center for the Study of Economics, 2000 Century Plaza, Suite 238, Columbia, MD 21044, (301) 740-1177. Editor: Steven B. Cord. Inquiries invited. Subscription rate $8/yr.

Definitions

Excise Tax - sales tax falling only on a few items.

Progressive Tax - takes a greater share of people's income as their income rises. Thus, a tax that takes 1% of a $15,000-a-year family, 3% of the income of $30,000-a-year family, and 5% of the income of a millionaire is a progressive tax.

Proportional Tax - takes a consistent and equal share of people's income as income rises. A tax amounting to 3% for each of the families above is a proportional tax.

Regressive Tax - takes a bigger share of people's incomes as income falls. A tax which takes 5% of the income of $15,000-a-year family, 3% of the income of a $30,000-a-year family, and 1% of the millionaire's income is clearly regressive.

From the Editor

Vol. XIV, No. 4

• Rep. Carville Foster, Jr. of Seven Valleys, Pa. has introduced a state-constitutional amendment into the Pennsylvania Legislature which would allow localities to exempt a fixed amount (say, $5,000) of improvement value (not land) from the local property tax. Obviously, a $5,000 exemption would of much greater value to the owner of a $50,000 home or small business, than it would to the owners of a $2 million factory. Yet all taxpayers would be treated equally.

This amendment failed by one mere vote in the Pa. House of Representatives recently, but Rep. Foster will persist. This approach is certainly preferable to exempting both land and improvements.

• Nationwide, the number of low-income families unable to find affordable housing rocketed from 8.9 million in 1974 to 11.9 million in 1983" (USN&WR 2/29/88, p. 34)

Significance: even after six years of no-recession, there is a howling need for land value taxation. Un-tax housing, make it cheaper; up-tax land, make land cheaper.

• Ted Gwartney, one of the country's leading assessors/appraisers, asserted at a recent conference of Common Ground/U.S.A.: "A re-assessment for a community usually costs between $15-$25 per parcel, but a land-only reassessment would cost only 10%-18% of that."

• Uh, oh - bad news. A brief study by the Wall Street Journal found the I.R.S. advisers gave more wrong answers to telephone inquiries than right answers (WSJ, 2/18/88, sec. 2, p. 1).

Don't blame these advisers - the law is complicated. Just don't prefer the income tax to the land value tax, that's all.

• If there are still any IT readers left who prefer the income tax to the land value tax, let them reflect on this news item in the Wall Street Journal of March 23, 1988: "It takes a household an average of 21.7 hours to do federal and state returns, says a University of Michigan economist. The cost averages $231 in personal time plus $44 in fees for professional aid."

Most taxpayers should add this 21.7 hours and $275 to what they would save with the land value tax. And then remember: the income tax deters incentive, LVT v.v.

• Here's a good-assessment idea: in Kansas, you can't insure your building for more than its assessed value (from Joe Casey, IT reader and bank examiner).

• Another good assessment idea: Maryland has state-hired assessors, and new assessments are phased in over a three-year period, so that a property which has been assessed at $100,000 three years ago but is assessed at $130,000 now, will be assessed for tax purposes at $110,000 next year, then $120,000 the following year, then $130,000 in the third year, at which time it will be subject to re-assessment. At least this prevents the jolt of a sudden increase in property tax due to real estate inflation.

• In Rome, N.Y., a home with three acres would save on property tax with a two-rate approach, according to Bill Glasso, City Treasurer. Reason: the three acres are not served by city water or sewer.

• In the Minneapolis Tribune: "Defendant's Speech Ends in Long Sentence."

Congress' New Housing Bills: Government's Latest Gift to Landowners

by Edward J. Dodson

Ask anyone directly involved in real estate development today what the single greatest obstacle to profitable development is and the answer will be the same: THE COST OF LAND.

Land values have skyrocketed during the past few years from Maine to Virginia and in many other parts of the country as well.

For those individuals who already own land or both land and buildings, tremendous unearned gains have been received (admittedly, realized only if they have actually sold their properties). The real impact has been, however, that most families have taken their gain and have had to put it right back into the purchase of another residential dwelling. Chances are that the new home increased as much or more than the one sold, and the family in this situation may have only marginally improved its standard of living.

A generally accepted principle of lending is that a homebuyer's monthly housing obligation, including taxes and insurance, should not exceed 25-28% of total monthly family income; at levels greater than this the likelihood of financial difficulty causing a loan default is an ever-present threat. Based on a very conservative median housing price of, say, $100,000, a buyer would need around $9,000 in cash and an annual family income of almost $50,000 in order to borrow $91,000 at 10% over 30 years. A large segment of our population is thus effectively priced out of the market.

Our government leaders want to subsidize the purchase of homes for low-income groups. Two primary tactics are followed:

(1) make the financing more affordable by subsidizing the rate of interest paid by the borrower; and

(2) subsidize the purchase of land so that housing can be built that will give to the developer a market rate of return but permit the purchase price to be lower than if the building lots had been directly acquired.

In the first instance, the general taxpaying public (including lower-income families) end up absorbing the interest subsidy in the form of higher taxes or higher costs for government services; there is no "free lunch."

In the second instance, we are all putting more money into the landowners' pockets, inasmuch as they receive a market price for the land - the subsidy given to the developer financed by the general taxation of individual wages and other taxes on productively-earned income.

Public policy fails to take into consideration some very clear economic principles: that land is a relatively scarce commodity; its suppy cannot be easily increased as can the supply of automobiles or even housing units (e.g., one can build up just as easily as out). Any special opportunities given to buyers of land in the marketplace beyond a certain level will change the relation between supply and demand; and, if lower interest rates or price subsidies or higher maximum loan amounts are granted to a large enough number of potential house buyers, the demand for land will increase - certainly not the supply - and landowners will ask more for their land and so ultimately they will reap the rewards of the lower interest rates and subsidies, not the poor. What has simply occurred is that the market has capitalized all of the subsidies and giveaways into higher land prices.

There is a solution to this dilemma, one that is deceptively simple. Adam Smith was one of the first to observe that taxes on productive activity (such as housing construction) will tend to add to the cost of the end good or service and thus discourage its production. Taxes levied against static activities (of which landownership is a prime example) tend, conversely, to stimulate production. The reason for this is easy enough to see: if I own a parcel of land worth $100,000 today, and it value is increasing at 10% per year, the land will be worth $110,000 in a year and I will have gained $10,000 without lifting a finger. If this land were taxed at 10% of market value, however, my net gain is zero and I will be induced to either develop the land myself or put it on the market for use by someone who will. The more land thus coming onto the market, the greater will be the pressure toward stabilization of the cost of land for development.

The issues raised by this problem involve more than economics. Is justice not better served by a system of taxation that rewards our citizens for their productive contributions to society, as opposed to the current structure, which perpetuates the transfer of wealth to those who gain by simply holding onto land? Landowning itself produces nothing, yet gives to titleholders an unearned claim on the fruits of the labor of others. To the extent this continues, we not only discourage economic growth but expose our democratic system to a deeply-rooted injustice.

Edward J. Dodson is an executive in Federal Natl. Mtge. Assn. ("Fannie Mae") and is also President of the Henry George School.

"There are thousands hacking at the branches of the tree of evil for every one who is striking at the root." (Henry David Thoreau)

"Political reform is the greatest sport the world affords." - Theodore Roosevelt

Endorsement 294

Pittsburgh Press (editorial, October 26, 1915): "The building up of enormous private fortunes at the expense of the community by holding land out of use until it becomes immensely valuable through the improvements erected on surrounding property is an evil witnessed in all cities. It is an abuse made possible, of course, only by the prevailing practice of taxing vacant land very low and buildings very high."

High Taxes Curb Economic Growth

by Gary Dodson

States having high tax burdens are experiencing little development and growth. Companies no longer willing to bear heavy tax payments are seeking new locations with better economic conditions.

From an article published in the San Francisco Chronicle, 12/30/86, p. 47, we learn of a new study by economists at the University of Alabama's Center for Business and Economic Research. The study concluded that "between 1967 and 1983, a significant negative relationship does occur between tax burdens and economic growth in most states."

In the state of New York, the study found that for every 1% increase in relative tax burden, real per capita income was reduced by 0.3%. In Alabama, it was reduced by 0.4%. Similar ratios were found for Wisconsin and Minnesota.

Massachusetts, by the passage of Proposition "2 1/2" in 1980 (property taxes were cut to a maximum of 2.5% of fair market value from 4%), experienced quite an economic boom. By reducing property taxes, Massachusetts experienced a surge in construction that lasted almost six years. The boom bottomed out by 1986.

Just think what might have happened in Massachusetts had they adopted a land value tax instead. If reducing property tax payments by 37.5% could produce a construction boom, isn't it likely that a complete shift in property taxes from buildings to land would produce even greater levels of new construction? Economic development in Massachusetts could still be going strong.

Income Taxes

Lest you think the local income tax might be viable alternative to the local sales tax, do be aware that since local income taxes are deductible from the federal income tax (not so for local sales taxes), then about a fifth of local income taxes are "exported" out of the locality.

In other issues, of this bulletin, we have excoriated the income tax because it is punitive, complicated, hardly progressive, and immoral insofar as it socializes individually-earned incomes. It also promoted illegality (via income-tax evasion and a widespread underground economy.) Otherwise, it's a great tax.

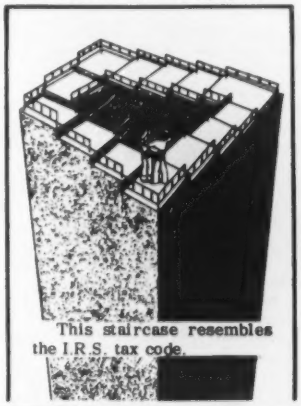
The Utility Tax is N.G.

Local and state governments tax electric[illegible]ities heavily, who then pass the tax on to electricity users, and the poor thereby get soaked. Here is a paragraph from an A. P. report on a study done by the Citizens for Tax Justice:

"The poor spend 6.2 percent of income on electrical bills, more than double the rate of the middle-income family. But that middle-family pays three times as big a share for electricity as do the rich, the study found." (3/25/88)

No doubt likewise with the telephone tax and water tax. These taxes can be justified only to the extent that they cover governmental costs for electric, telephone and water regulation (but these are currently a small part of the total taxes collected on these vital services).

It would be better to tax land values. Such a tax would fall much less heavily on the poor, and it would spur economic renewal and re-employment.



This staircase resembles the I.R.S. tax code.

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May 1990

Incentive Taxation

The Deficit: Huge & Growing
Soon LVT Will Be the ONLY Viable Alternative

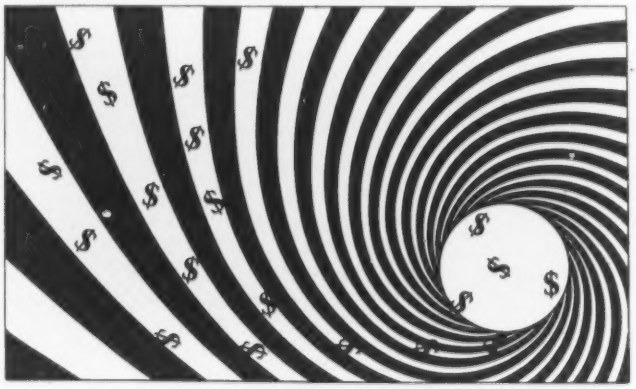
"U.S. Fails to Trim Government Deficit, Posts $152.08 Billion Gap for Fiscal '89"

So reads the headline in the October 30, 1989 issue of the Wall Street Journal (p. A12). The deficit is about the same as it was for the two previous years, even though some expenses (for bankrupt S&L's, for instance) were pushed into the fiscal 1990 budget. And when the next recession arrives, then all bets are off as tax revenues will sink and expenses will expand.

Interest paid on the public debt -- $240.86 billion (and rising) -- has exceeded social-security spending, formerly the single largest govt. program (Ibid.).

All this wouldn't be so bad if personal and corporate debt weren't also at all-time highs, and apt to grow.

(1) THE DEFICIT IS LARGER THAN YOU THINK -- The deficit figure given above doesn't include many such off-budget items as nuclear-bomb factory cleanup, new tritium reactors, hazardous-waste pollution at army sites, road and bridge maintenance, SDI plans, space station costs, new Bush and Congressional proposals (e.g., child-care, etc.) (USN&WR 11/12/88, p. 24).



- Many items in the budget are almost non-cuttable since they deal with so-called entitlements or pork-barreling, which is why our taxes per GNP are higher than ever, even despite Reagan (under his administration, not only did defense expenditures increase but so did domestic expenditures).
- The deficit does not include trillions of dollars of unfunded liabilities, such as for social security (Reason 7/89, p. 56), also Freddie, Sallie and Fanny Mae corporations (WSJ, 7/17/89, p. 1, also Reason, 7/89, p. 56, quoting Peter Peterson & Neil Howe). Some of these unfunded liabilities have already gone bad (but have not yet been written off), and more will go bad in time.
- Don't put your faith in Gramm-Rudman: it is probably unconstitutional (see Rep. Ben Cardin's 1987 Report), and it certainly is a sham. Says Senator Ernest Hollings: "I'm one of the authors and Gramm-Rudman isn't working. It's a total charade" (Wash. Monthly, 5/89, p. 38).
- The official budget deficit of $152.08 billion (as listed above) assumes a too-low interest rate for next year of 5 1/2%; it is currently above 8%. It also assumes a too-high rate of economic growth (WSJ, 4/26/89, p. A15).
- This year's deficit has been reduced by a one-time sale of federal property (Cardin's 1987 Report).
- The Pentagon has a secret more-realistic budget that is $45 billion higher for the next five years than the official budget it has presented (USN&WR, 5/1/89, p. 23, citing a GAO study).
- The feds should be setting aside an additional $12.4 billion for the U.S. Railway Association.
- $21 billion in the aviation and highway trust funds have been included in the federal budget to make the deficit appear smaller (USN&WR, 7/24/89, p. 25).
- The recent H.U.D. scandal will cost the feds an extra $6-8 billion (Newsweek, 8/7/89, p. 16).
- The Post Office subsidy of $2.2 billion has been moved off-budget; $1 billion in agricultural subsidy has been advanced to next year's budget (USN&WR, 6/5/89, p. 71). We have already alluded to the S&L bailout, but it is instructive to note that the GAO predicts that bailout is about double current estimates

(continued on next page)

(continued from previous page)

(USN&WR, 6/26/89, p. 21) which in turn are much more than the first estimates.

• Past-due borrowers are into the Farmers Home Administration for $8.7 billion (WSJ, 9/5/89, A18).

• The un-funded liabilities mentioned above come to about $719 billion (USN&WR, 3/20/89, p. 92 [Zuckerman editorial] and 11/12/88, p. 24, also WSJ 7/27/89, A12), but be sure to add billions more to modernize the computer systems for the IRS, social security and air-traffic control administrations (Zuckerman editorial), and $20 billion for public-housing renovation (WSJ above). Since most of these are early estimates, they are in fact under-estimates, and in any case this list is only partial.

• Federal relief efforts to alleviate the effects of the recent Hurricane Hugo and San Francisco earthquake (and who knows what other natural disasters will occur?) will worsen the deficit.

• So will the war on drugs.

As you might expect, this is an incomplete list. Just my own files alone include many more items, but enough is enough to prove the point that the deficit is larger than you think, and bound to grow.

(2) THE DEFICIT CAUSES SERIOUS PROBLEMS -- Don't think that the deficit has no serious consequences merely because (at this writing) we have not suffered a recession yet:

• It defers taxes onto future taxpayers. We get the benefits, they get the bill, and they haven't voted on what we will visit upon them.

• It crowds out private borrowers. The more the government takes, the less there is left over for private borrowers, and the more they must pay for loans. The resulting high interest rates inhibit growth and lead to recession.

• It dis-equalizes the distribution of wealth. A high deficit means higher taxes for poor and average incomers, with interest payments going to the already wealthier.

• A huge deficit hurts our exports by attracting foreign capital to our higher interest rates; when this occurs, they have less money available to buy our exports (incidentally, when foreigners buy up American real estate, the only tax that reaches them is the land value tax -- they can pass on to consumers the property tax on buildings).

• Since the deficit raises interest rates, federal govt. interest costs are also boosted.

• A high deficit now makes it more difficult to borrow our way out of a future recession.

(3) SHOULD WE INCREASE PRODUCTION TAXES TO PAY OFF THE DEFICIT? No, for these reasons:

• We'll kill the goose laying the golden eggs; i.e., we will inhibit production if we tax it heavily to make a dent in the deficit and that will only serve to bring on sooner a deficit-enhancing recession. In addition, if we increase taxes on production, then the government will spend a good part of that revenue; not all of it will go to deficit reduction, if history is any guide.

• The current tax system is tilted against the poor and middle-class -- if the feds took every penny over the $75,000 tax bracket that isn't already taxed, it would only collect enough money to run the country for a week (Grace Co. ad, USN&WR 1985).

(4) TAX LAND VALUES INSTEAD, for these reasons:

• It will require land to be used efficiently. After all, if the rent of land is collected in taxation, then the landowner will have to put up an improvement sufficient to pay for the higher land rent, plus a suitable profit on the cost of the improvement.

• We can transfer taxes off production. Wouldn't you prefer to live in an economy where all producers were tax-free?

• Wouldn't our exports be cheaper and therefore more competitive on the world market if they do not have to bear any taxes? A tax on land values will not increase the costs of exported commodities or services (or domestically consumed commodities or services, either).

• A tax on land values could maintain the current level of government services.

• Such a tax would reduce the cost of land to labor and capital, the real producers.

• Above all, it would prevent the robbery of at least 25% of all labor-produced production. If labor and capital produce the entire GNP, then what is left to be paid to landowners? And if they do get paid, is it not true that they do nothing (neither they nor the previous owners of their lands produced the land; God did) and yet they have a legal claim on those who did? If they retain an income, it must deny to the true producers (labor and capital) the full fruits of their labor. It cannot be otherwise, no matter how many workers and businessmen acquiesce.

WHAT THE FEDERAL GOVERNMENT CAN DO

In view of the foregoing, there are many actions which federal government officials can and should take:

• The federal government could tax all income from land (imputed, currently collected, or from sale), or it could levy an equal per-capita tax on all states, with the proviso that the states should levy a tax on their own land values (this was often done in the 19th century).

• Federal offi cials could start now to popularize land value taxation in an effort to win public support for it. This is not the work of a day, and it requires real personal commitment, but the benefits beckon. "A journey of a thousand miles begins with but a single step."

• The federal government should invest $50-$100 million into the establishment of a new city where the public revenue would be derived from land rent only. This would serve as a demonstration of what land value taxation could accomplish.

• Cities which adopt land value taxation could receive preference in qualifying for federal grants (e.g., enterprise zones). Should they be mere passive recipients of federal aid, or should they also be asked to do something to help themselves?

There is a silver lining to the huge and growing cloud of the federal deficit. It may force us to do what we should always have done in the first place: tax land values, not labor or the products of labor. We may soon have no other choice.

Correction

In the March 1990 issue of *Incentive Taxation*, we mistakenly reported that TAX TALK is a publication of the Michigan Municipal League. TAX TALK is published by the Michigan Tax Information Council. We regret the error.

"WARNING: This periodical may be hazardous to your point of view."

How the Federal Government Could Levy a Tax on Land Values

PURPOSE - In order to reduce taxes on producers while at the same time reducing the federal deficit, Congress could levy a tax on land values instead.

BENEFITS - Reduce taxes on producers. Pay off the budget deficit. Make American exports cheaper, thereby reducing the trade deficit. Encourage the more efficient use of land, thereby increasing production and the standard of living. Tax more according to ability-to-pay. Let government tax what it creates (via roads, protection, public works, etc.), which is the locational value of land.

PROPOSAL - Congress should levy a tax on land values, apportioning it among the states according to population. For instance, if it wishes to raise $18 billion, or $75 per capita ($18 billion divided by 240 million U.S. population), then it should tax the assessed land value of each state by whatever percentage tax rate which would raise the revenue required. If a state had 2 million population, then Congress would tax its land value by whatever percentage tax rate would be needed to raise $150 million (2 million times $75). The percentage land value tax rate would therefore vary somewhat from state to state.

CONSTITUTIONAL BASIS - The Constitution clearly states that Congress can levy direct taxes (like a land value tax) "among the several states according to population." In fact, it raised $2 million in 1798 by imposing a tax upon "dwelling houses, lands and slaves, according to value." In 1813, Congress levied a tax "upon real estate and slaves, according to value;" again in 1815 with a tax upon "the values of all lands and lots of ground, with their improvements, dwelling houses and slaves," and once again in 1861 on the same values (thereby raising $20 million in revenue).

FURTHER DETAILS - The land value percentage-rate levied by Congress in each state should be applied by the state to locally assessed land values as adjusted by the state's equalization ratio of assessed-to-market value (with special abatements for agricultural use allowed). If there is a state which does not have assessment-equalization ratios, then the federal government shall establish those ratios.

One-quarter of all the revenue from this tax shall be retained by the states and localities from whence it is collected. This revenue sharing may be used to reduce non-property taxes or for such other purposes as the states and localities deem necessary.

To give added benefits to homeowners and farmers, a $100 assessment exemption per taxpayer could be offered.

The various states shall collect this tax and forward the revenue received to the Treasury Dept. less their 25%.

In those rare cases where local assessments do not differentiate between the value of land and buildings, then for vacant land, 100% is designated as land value; for residential property, 30%; for commercial property, 40%; for industrial and utility property, 35%; for farm property, 60%; for mineral property, 70%. If the taxpayers in these localities object to these allocations, they may follow the more typical practice of separately assessing land and building values.

Land values are the products of the efforts of society and government, which by providing jobs, shopping, protection, roads, schools, hospitals, etc., increase the locational value of land. Hence, society and government should collect what they create before they collect what individuals create (i.e., wages, capital investments, retail sales, etc.).

The alternatives to a federal tax on land values is a burgeoning deficit or onerous taxes on private initiative. Which should we choose?

From the Editor

Vol. XVI No. 2

• Land value taxation is "the golden key to urban renewal - to the automatic regeneration of the city and not at public expense." (Urban Land Institute Research Monograph #4)

• The Japanese legislature is planning to substantially reduce excise taxes, thus boosting consumer spending and economic growth (WSJ, 12/12/88, C1).

Significance: taxes are important. Tax land, not consumers.

• Individual real weekly earnings have dropped 10% since 1969 - USN&WR, 3/7/88, p. 4.

Significance: our economic arrangements need muchly to be improved. Don't argue against LVT because we are so well off now.

• One in five children fell into poverty in 1986, yet the federal government spends 11 times as much on each senior as it does on each child. And the imbalance is scheduled to grow more marked in ensuing years. (USN&WR 10/31/88, p. 55)

• Magazine publishers are suing the state of Maryland over its 5% sales tax; ditto in Florida. Tax land, no sales. (Publ. News, 2/89, p. 1)

• You can lease a patch of water 30 ft. wide by 150 ft. long at the new yacht marina near Wall Street in NYC for $1,575,000/yr. But hurry, the berths are being snapped up fast by mega-yacht owners (WSJ, 3/21/89 - p. 1).

Land is important. Don't do economics without it.

Endorsements 321 – 322

State Representative Calvin Skinner (Rep., Illinois, as reported in "Crain's Chicago Business," 3/26/79, John Robert's column) says he has the answer to the problems of saving Chicago's neighborhoods, and at no cost to the taxpayer. He introduced a bill which would allow cities to shift the tax burden from land and buildings to land alone. "This," he said, "would provide rational growth control in the suburbs."

Citizens Property Tax Commission (established by the state of Michigan, p. 37 of 1987 report): "A land value taxation system could be advantageous for areas that experience property value decline. Vacant land held for speculative reasons stymies development in these areas and vacant parcels contribute to further deterioration of the property tax base. Development in those areas is encourged because vacant land is no longer cheap to hold under a land-value taxation system."

"While Land Prices in Japan Soar, Officials Fight Back With Words"

If someone tries to tell you that land is unimportant in economics, he surely isn't from Japan.

The above headline appears above a page I article in the Sunday, March 25, 1990 edition of the New York Times. The following quotations are taken from that article:

"Each of the last four years, the Government of Japan has declared a well-publicized war on this country's astronomical and still-rising land prices, the world's highest. But despite the strong oratory, the soldiers in the war never seem to leave their barracks."

"Some pople warn that high land prices threaten to split Japan into a two-tier society of haves and have-nots."

"...interest groups exercise extraordinary influence...inefficiencies reside at the heart of the Japan's economy...."

"The total 1988 market value of land in Japan, a nation roughly the size of California, is estimated at $15 trillion, or five times that of the United States, according to the Long-Term Credit Bank of Japan."

[We beg to differ: our research indicates that land values in the United States approximate $15 trillion.]

"In Tokyo, the Japanese policy has resulted in a crazy quilt of small, sometimes minuscule plots, rather than larger sites that allow more extensive development. In the middle of the Ginza, the most expensive commercial district in the world, there are Lilliputian structures on lots as small as 6 feet by 18 feet."

"Capital gains taxes of as much as 94 percent discourage land sales, with owners preferring to keep land idle rather than sell it for more efficient uses."

"Extremely low property taxes encourage people to buy and hold land as a store of wealth rather than put it to use."

"Too much urban land is still designated agricultural land and taxed at a rate about a tenth of regular land taxes. This provides little incentive for the land to be put to other uses."

"'If Japan raised land-holding taxes to the level of the United States, I'm sure prices here would fall,' Mr. Harada said. 'All economists agree on that point. Prices would fall by maybe a third or a fourth.'"

[Unfortunately, the article didn't identify who Harada is. But the article implies that if the U.S. removed all property taxes -- no real worry because those taxes bring in too much revenue -- then land prices would zoom up three or four times to Japanese levels; anti-property taxers should take note. They should direct their energies toward the abolition of income, sales, and building taxes.]

"An official at the National Land Agency said: 'Some kind of change in the tax system should be taken. That is the only way to change the supply of land on the market.'"

Conclusion

Don't be too harsh, IT readers, on the N.Y. Times journalist. He does infer that higher land value taxes were the solution to this, "one of Japan's worst domestic problems." He (or his editors) just didn't stress it adequately.

(We thank IT reader Jacob Himmelstein for sending us a copy of this New York Times article)

INCENTIVE TAXATION

CSE

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